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In the Supreme Court

OF THE

United States

OCTOBER TERM, 1959

No. 791

EDWARD J. BLOOM,
Petitioner,

vs.

UNITED STATES OF AMERICA,
Respondent.

PETITION FOR WRIT OF CERTIORARI
to the United States Court of Appeals
for the Ninth Circuit.

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No.

EDWARD J. BLOOM,
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UNITED STATES OF AMERICA,
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PETITION FOR WRIT OF CERTIORARI
to the United States Court of Appeals
for the Ninth Circuit.

Edward J. Bloom respectfully petitions for a writ of certiorari to review the judgment of the United States Court of Appeals for the Ninth Circuit which affirmed the judgment against petitioner by the United States District Court for the Northern District of California, Southern Division, for the sum of $19,292.79, representing a penalty assessed against him under the purported authority of Section 2707(a) of the Internal Revenue Code of 1939, 26 U.S.C.A. §2707(a).

OPINIONS BELOW.

No written opinion was filed in the District Court (where the action was numbered 35070). The judgment entered therein against the petitioner is set forth at pages xviii and xix of the Appendix. Mandate was stayed pending the filing of this petition.

The opinion of the Court of Appeals for the Ninth Circuit (R. p. 15) is reported at 272 F. 2d 215. A timely petition for rehearing was filed in the Circuit Court on December 31, 1959, which petition was denied on January 20, 1960, without written opinion. Mandate was stayed pending the filing of this petition.

JURISDICTION.

The jurisdiction of the Supreme Court is invoked upon the grounds that the Court of Appeals for the Ninth Circuit has, by its decision and judgment, denied the petitioner of his property in violation of Amendment V of the Constitution and deprived him of his right to a jury trial in violation of Amendment VII of the Constitution. Said decision is also in direct conflict with applicable decisions of this Court and is so far a departure from the accepted and usual courses of judicial proceedings, and sanctioned such a departure by the District Court, as to call for an exercise of this Court's power of supervision.

The judgment of the Court of Appeals for the Ninth Circuit was made and entered on November 2, 1959 (R. p. 15), and a copy thereof is appended to this petition in the Appendix at page xvii. The specific

statutory basis for this Court's jurisdiction is that of 28 U.S.C. 1254(1).

QUESTIONS PRESENTED.

1. Where recovery against a corporation for failure to pay withholding taxes is barred by the statute of limitations, may the government nevertheless later maintain a penalty action against the individual who was purportedly the responsible officer of said corporation, where there is no transferee liability.

2. May a *penalty* be levied against an individual taxpayer, tax liens recorded against him, and warrants for the distraint of his property issue without any notice of deficiency or opportunity for hearing?

3. If the Tax Court of the United States held it was deprived of jurisdiction because the liabilities in question are denominated "penalties" by the terms of Section 2707(a) of the Internal Revenue Code of 1939, can the United States in the same case later claim the "penalty" levied was in fact a "tax" duly assessed?

4. Is Section 2707(a) of the Internal Revenue Code of 1939 a penal statute or a tax statute?

5. May an individual taxpayer be held personally liable for the penalties imposed by Section 2707(a) of the Internal Revenue Code of 1939 for "*willfully*" failing to pay taxes withheld by a corporation of which he was a shareholder and officer, when the *uncontradicted documents and testimony* introduced at the trial reveal that the corporation at *all* times

operated exclusively on a trust receipt basis of financing, and *never* actually had *title to or the power to dispose* of funds without the consent of the trustor, which was *refused* insofar as the payment of taxes was concerned; and when under the evidence and terms of the trust receipts and loan agreements checks were drawn and paid by the loaning bank for the net amount of wages paid as an overdraft and no funds were in fact in the corporation's account to be "withheld."?

6. May an individual taxpayer be held personally liable for the penalties imposed by Section 2707(a) of the Internal Revenue Code of 1939 for *"willfully"* failing to pay taxes withheld by a corporation of which he was a shareholder and officer, when the *uncontradicted documents and testimony* introduced at the trial disclose that he would have been *guilty of a felony* under the laws of the State of Washington for *misapplication of the trust property if he had made such payments?*

7. Is Section 2707(a) unconstitutional and void as applied to the petitioner as a violation of Amendments V and VII of the United States Constitution?

8. May a person be held to be the *"responsible officer"* of a corporation whose duty it is to pay withholding and social security taxes as provided by Section 2707(a) of the Internal Revenue Code of 1939, when the *uncontradicted testimony and documents* introduced at the trial disclose that the corporation at *all* relevant times operated on a trust receipts basis of financing, exclusively on overdrafts paid by the

loaning bank, and that he had to obtain the *consent* of the *trustor* bank before making any payment, such consent being manifested by payment by loaning bank of checks drawn against corporation's account, corporation having custody only in trust of property pledged to secure payment of notes to bank, and no cash proceeds of such notes?

CONSTITUTIONAL PROVISIONS AND STATUTES.

The Fifth Amendment to the Constitution of the United States provides (insofar as here applicable):

> "No person shall be deprived of life, liberty, or property, without due process of law . . ."

The Seventh Amendment to the Constitution of the United States provides (insofar as here applicable):

> ". . . the right of trial by jury shall be preserved . . ."

Section 2707(a) of the Internal Revenue Code of 1939, provides as follows:

> "(a) Any person who willfully fails to pay, collect, or truthfully account for and pay over the tax imposed by section 2700(a), or willfully attempts in any manner to evade or defeat any such tax or the payment thereof, shall, in addition to other penalties provided by law, be liable to a penalty of the amount of the tax evaded, or not paid, collected, or accounted for and paid over, to be assessed and collected in the same manner as taxes are assessed and collected. No penalty shall be assessed under this subsection for any offense

for which a penalty may be assessed under authority of section 3612."

Section 2707(d) defines "person" as follows:

"(d) The term 'person' as used in this section includes an officer or employee of a corporation, or a member or employee of a partnership, who as such officer, employee, or member is under a duty to perform the act in respect of which the violation occurs."

Section 2700(a) reads as follows:

"(a) *Rate.* There shall be levied, assessed, collected, and paid upon pistols and revolvers sold or leased by the manufacturer, producer, or importer, a tax equivalent to 10 per centum of the price for which so sold or leased."

Sections 1400 through 1430 of said Code constitute Subchapter A of Chapter 9, and relate to employment or F.I.C.A. taxes. Section 1400 deals with tax rates, and Section 1430 reads as follows:

"All provisions of law, including penalties, applicable with respect to any tax imposed by section 2700 or section 1800, and the provisions of section 3661, shall, insofar as applicable and not inconsistent with the provisions of this subchapter, be applicable with respect to the taxes imposed by this subchapter."

Sections 1621 through 1636 of said Code constitute Subchapter D of Chapter 9, and relate to collection of income tax at source on wages. Section 1627 reads as follows:

"All provisions of law, including penalties, applicable with respect to the tax imposed by section 1400 shall, insofar as applicable and not inconsistent with the provisions of this subchapter, be applicable with respect to the tax under this subchapter."

STATEMENT OF THE CASE.

This action was brought by the United States to reduce to judgment a certain penalty which the Commissioner of Internal Revenue had made against Edward J. Bloom and his wife under the purported authority of Section 2707(a) of the Internal Revenue Code of 1939.

The "assessed" penalty arose by reason of the failure of Idaho Smelting Inc., a Washington corporation, to pay certain "withheld" income taxes and employment taxes. Exhibit K shows that the corporation was given authority to write checks under the Canadian style of banking, such checks being overdrafts of its account up to sums in excess of $50,000 but without such funds being in fact in existence in the account of the corporation or otherwise available to it, except at the discretion of the loaning bank.

Petitioner has always contended that he did not willfully fail to pay the corporation's taxes, and that he was not the person required to pay, collect, or truthfully account for and pay over the tax imposed on the corporation, because the corporation never had possession of funds except in trust under the trust receipt act.

The following facts are uncontradicted:

After four years' service in World War II as an officer in the United States Navy, Edward J. Bloom returned to civilian life in 1945, and entered the smelting business.[1] He was a licensed metallurgist.[2]

He formed and operated the Idaho Company, an individual proprietorship, for the purpose of purchasing wrecked aircraft (chiefly from the War Assets Administration), making aluminum alloy ingots from the scrap, and selling the ingots to foundries. He designed and built a portable train, which consisted of smelting furnaces mounted on railway flat cars, and this train was run to the different places where the Government had accumulated the scrap, and the ingots were made at such points. For such purposes, the train went to Fort Lewis, Washington, Harbor Island, Seattle, Washington, and Corpus Christi, Texas.[3]

Mr. Bloom invested his savings and certain inherited funds, and also borrowed money from the Seattle Trust and Savings Bank, for the purpose of financing the business.[4]

During 1945 and 1946, the scrap aluminum business was extremely profitable. For the year, 1945, Mr. Bloom and his wife paid income taxes in excess of

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[1]R.T. p. 40, lines 7-14.

[2]R.T. p. 41, lines 2-3.

[3]R.T. p. 40, line 15 thru p. 41, line 2; p. 41, line 15 thru p. 42, line 17.

[4]R.T. p. 44, lines 4-21.

$22,000.00.[5] And in 1946, both his accountant and his lawyer recommended the formation of a corporation to carry on the smelting business.

On or about July 1, 1946, therefore, Idaho Smelting, Inc., a corporation, was formed under the laws of the State of Washington, with its principal office in Seattle, Washington.[6]

The corporation had two classes of stock—preferred and common.[7] Mr. Bloom transferred to the newly formed corporation the assets which had belonged to his business, the Idaho Company, including the train, the inventory, and accounts receivable, of an aggregate value of between $66,000.00 and $90,000.00, in exchange for common stock.[8] He was the majority stockholder, although not the sole stockholder of the common stock,[9] and was the president.[10]

He spent most of his time traveling for the corporation, and was in Seattle for only five or six days each month.[11] Other officers in addition to Mr. Bloom were authorized to sign checks,[12] and Mr. Bloom relied on the corporation's bookkeeper and certified public accountant in so far as financial records and tax

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[5]R.T. p. 44, lines 9-13.
[6]R.T. p. 47, lines 8-19.
[7]R.T. p. 47, lines 22-23.
[8]R.T. p. 48, lines 13-20; p. 49, lines 2-4.
[9]R.T. p. 66, lines 21-23.
[10]R.T. p. 66, lines 12-14.
[11]R.T. p. 62, line 20 thru p. 63, line 7.
[12]R.T. p. 63, lines 7-14; lines 21-22; p. 64, lines 10-18.

returns of the corporation were concerned.[13] It was his belief that the corporation was making money.[14]

On or about May 15, 1946, Mr. Bloom had entered into a certain written Loan Agreement with the Seattle Trust and Savings Bank, which provided for the financing of the Idaho Company up to the sum of $849,000.00.[15] Upon the formation of Idaho Smelting, Inc., the Bank agreed to make the same financing agreement with the corporation; and upon the adoption of the necessary corporate resolution, this was done.[16]

The corporation, pursuant to its agreement with the Bank, operated under a trust receipts plan and on an overdraft basis (sometimes referred to as the Canadian style of banking) with the Bank.[17] Necessary notices were filed with the State of Washington pursuant to the Uniform Trust Receipts Act.[18]

When the corporation desired to purchase some metal it would obtain a letter of credit from the Bank to the War Assets Administration, or other seller, and process the same; when the corporation sold the resulting aluminum ingots the entire proceeds from the sale went to the Bank which had meanwhile honored overdraft checks for payroll for the expense of

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[13]R.T. p. 67, lines 1-23.

[14]R.T. p. 123, lines 8-12.

[15]R.T. p. 44, line 18 thru p. 45, line 13; Exhibit A.

[16]R.T. p. 49, line 16 thru p. 50, line 25; Exhibits B and C; R.T. p. 62, lines 5-19; Exhibit F.

[17]R.T. p. 70, lines 6-17.

[18]R.T. p. 56, line 17 thru p. 57, line 25; Exhibit G.

processing. The letters of credit did not represent any cash to the corporation, but merely constituted a method of passing title to the inventory from the War Assets Administration to the Bank. The Bank was the boss at all times, and used the proceeds as it saw fit—to pay off a note from Idaho Smelting, Inc., to the Bank, to pay overdrafts, or for some other purpose.[19] Also the Bank held chattel mortgages on certain personal property of the corporation, namely, the train and the ingots inventory.[20]

The corporation's accounts payable were handled in the following fashion. Once a month, either Mr. Bloom, or in his absence another officer of the corporation, would take the list of accounts payable that had been prepared by the corporation's bookkeeper and accountant, to the Bank, and go over the list with Mr. Winslow, the vice president. Mr. Winslow would then indicate those bills for which the Bank would honor overdrafts. Such overdrafts often exceeded $50,000.00, and prior to 1948 Mr. Winslow always granted the corporation's request to pay any taxes on an overdraft basis without delay.[21]

In 1947, the corporation acquired a plant site in Tacoma, consisting of 45 acres on the Puyallup waterway at the entrance to Commencement Bay, for the then very reasonable price of $45,000.00, without any cash down-payment, and on the basis of a 100% loan from the Pacific First Seattle Savings and Loan

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[19]R.T. p. 52, line 1 thru p. 54, line 20.

[20]R.T. p. 100, lines 13-17.

[21]R.T. p. 58, line 24 thru p. 59, line 10; p. 111, lines 15-17; p. 78, lines 11-15.

Society of Tacoma. The monthly payments were $1,077.00.[22]

Unfortunately, about September, 1947, the metal market dropped drastically. There was no longer a shortage of metal. Foundries did not want to stock large amounts, and Idaho Smelting, Inc., was left holding a large inventory for which there was no immediate demand.[23] The organization, nevertheless continued in operation, hoping to weather out the recession, although, obviously, since it was not making large sales it could not meet its obligations to the Bank promptly.

On or about January 20, 1948, the Bank informed Mr. Bloom that "We are not at all satisfied with the progress which is being made to place the account of Idaho Smelting, Inc., on a satisfactory basis." About that time, Mr. Bloom took a list of accounts payable to the Bank, and, as was his custom, asked Mr. Winslow to honor certain checks the corporation contemplated drawing on an overdraft basis. For the first time, Mr. Winslow refused to agree to honor the complete list in the immediate future. He declined at that time to honor a check which the corporation intended to draw in favor of the Internal Revenue Service for payment of certain Withheld Income Taxes and F.I.C.A. taxes; stating that the amount of the corporation's loan was excessive in view of the deepening business depression in early 1948, and further stating

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[22]R.T. p. 91, line 20 thru p. 93, line 8.

[23]R.T. p. 61, lines 16-23.

that if the corporation would go along with the Bank and do what it said, the money would be available shortly. Actually, Mr. Bloom had no choice. The corporation had to go along with the Bank. Idaho Smelting, Inc., had no cash in its possession with which to pay the taxes.[24] All funds which did pass through the corporate accounts were released to it in trust by the bank for a particular purpose.

Mr. Bloom consulted the corporation's counsel, Mr. Tracy Griffin (who, unfortunately, died in 1947, prior to the time of the trial), and Mr. Griffin stated that the law required a tax return for the withheld taxes and the F.I.C.A. taxes to be filed by January 31, 1948, whether the tax was paid by then or not. Pursuant to such advice, the tax return was filed, but since the corporation had no funds, no payment accompanied it.[25]

The corporation had had about seven or eight executive employees and about fifty other employees prior to 1948.[26] After Mr. Bloom became aware of the unpaid taxes in January, 1948, the personnel was greatly reduced, and the plants at Tacoma and Harbor Island were shut down until financing would become available to the corporation.[27] The corporation's plants at Corpus Christi, Texas, and Hawaii continued in operation, for the Seattle Trust and Savings

[24]R.T. p. 78, line 4 thru p. 79, line 6; p. 83, lines 1-7.

[25]R.T. p. 79, line 20 thru p. 80, line 1; p. 129, lines 21-23; p. 11, lines 8-9.

[26]R.T. p. 107, lines 21-25.

[27]R.T. p. 130, lines 2-9.

Bank released funds in trust under trust receipts for their operation. However, instead of permitting the metal to go to the Tacoma plant for alloying, the Bank forced the sale of the metal at a loss as scrap ingots, to the American Smelting & Refining Co.[28]

Quarterly returns on theoretically withheld income taxes and F.I.C.A. taxes were filed by the corporation for the quarters ending March 31, 1948, June 30, 1948, September 30, 1948, and December 31, 1948, but payments did not accompany the returns, because the Bank would not agree to release funds for that purpose at the time such taxes were due.[29] At least once a month during 1948, Mr. Bloom asked the Bank to permit the payment of the accrued taxes. The Bank never refused; Mr. Winslow simply indicated that such payments would have to be put off for a little while. He said that when the corporation's loans had been repaid there would be adequate collateral left which the corporation could use to pay the taxes.[30]

Mr. Bloom explored with Mr. Winslow the possibility of the issuance of debenture bonds by the corporation to its creditors, and Mr. Winslow encouraged such action.[31] Debenture bonds aggregating $106,000.00 in amount were issued. The Seattle Trust and Savings Bank to whom the corporation was indebted, and from whom it obtained in trust its operating funds, became the trustee and paying agent for the

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[28]R.T. p. 127, lines 11-18.
[29]R.T. p. 129, line 25 thru p. 130, line 1; p. 141, lines 9-23.
[30]R.T. p. 125, lines 3-24; p. 83, line 17 thru p. 84, line 4.
[31]R.T. p. 81, lines 18-21; p. 84, lines 8-23.

coupons. The bonds stated that they were general obligations of Idaho Smelting, Inc., and that they were subordinate to the real estate mortgages, chattel mortgages, and tax liens.[32] Thus Bloom and the corporation recognized the corporations tax debt and so advised creditors.

About April 15, 1948, Mr. Bloom conferred with a deputy in the office of the Collector of Internal Revenue at Seattle, and explained the corporation's circumstances.[33] Subsequently, he and the corporation's counsel, Mr. Griffin, visited Mr. Clark Squire, who was then Collector of Internal Revenue, and further discussed the problems.[34]

By the middle of July, 1948, virtually all the creditors of Idaho Smelting, Inc., had accepted debenture bonds. Indeed, the local Collector of Internal Revenue at Seattle received approximately $13,000 worth of them, and forwarded them to Washington, D.C., with the recommendation that they be accepted. However, Washington rejected them. At the time of issuance of the bonds, it was anticipated that the corporation would be able to pay these debentures with funds received from certain future rentals and other operations.[35]

In addition to his efforts to finance the corporation by means of the debenture bonds, Mr. Bloom at the same time sought to save the corporation's equity in

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[32]R.T. p. 90, lines 5-12.
[33]R.T. p. 130, lines 9-25.
[34]R.T. p. 131, lines 4-6.
[35]R.T. p. 138, lines 1-13.

the 45 acres of real property in Tacoma, and certain other property of the corporation. He attempted to secure loans for the corporation from other banks and from the Reconstruction Finance Corporation, but without success.[36]

Meanwhile, the Internal Revenue Service filed tax liens against the corporation, about July, 1948.

It was not until January, 1949, that it became clear to Mr. Bloom that the Bank was never going to honor any overdraft in favor of the Internal Revenue Service.[37] The Bank continued to operate under its Loan Agreement with the corporation throughout the year 1948. By that time, Idaho Smelting, Inc., had paid its entire indebtedness to the Bank in full, and *then* the Bank told Mr. Bloom that since the Government had filed tax liens against Idaho Smelting, Inc., the Bank didn't feel it could do any further business with the corporation and would grant no further credit to it.[38] Until that time, Mr. Bloom was unaware that the corporation was being liquidated by the Bank for its own sole benefit.[39] By that date the withheld income taxes and F.I.C.A. taxes of the corporation, Idaho Smelting, Inc., which are referred to in plaintiff's complaint had accrued.

Having already invested so much of his time, money, and effort in the enterprise, and believing that the corporation could again make money as it had in

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[36]R.T. p. 133, lines 7-25.

[37]R.T. p. 125, line 25 thru p. 126, line 9.

[38]R.T. p. 91, lines 9-19; p. 133, lines 22-25; p. 141, lines 21-23.

[39]R.T. p. 134, lines 5-15; p. 122, lines 11-13; p. 123, lines 1-12.

the past, Mr. Bloom continued with his endeavors to try to save the dying corporation. He inherited certain funds, and by using these personal funds and his savings he managed, personally, to pay the coupons on the debenture bonds for about two years, to the extent of about $4,500.00. He was also able to reduce the principal due on the mortgage of the 45 acres at Tacoma from the original $45,000.00 to $25,181.11 by December, 1951.[40] These were direct payments by Mr. Bloom and never reached the corporation's bank account. So Mr. Bloom never made a choice of creditors to be paid with funds of the corporation, or under its control; only with his own funds was such choice made and they were not commingled with the funds of the corporation.

However, such personal efforts were not enough to get the corporation back on its feet, primarily because of tax liens. In either late 1953 or early 1954, there was a foreclosure sale of the Tacoma property.[41] Both the State of Washingon and the Federal Government distrained upon the assets of the corporation, and the corporation was dead.[42] The Internal Revenue Service apparently applied the funds it received from such sales on the corporation's delinquent taxes, but the appellant does not know the amounts recovered.

On November 23, 1949, the Commissioner of Internal Revenue "assessed" against Edward J. Bloom

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[40]R.T. p. 89, line 13 thru p. 90, line 3; p. 95, line 23 thru p. 96, line 10.

[41]R.T. p. 93, lines 13-15.

[42]R.T. p. 95, lines 1-5.

and his wife, certain taxes, aggregating $13,448.45, and representing the delinquent withholding taxes and F.I.C.A. taxes originally assessed against the corporation, Idaho Smelting, Inc., under the theory that they were "persons who had wilfully failed to pay, collect, or truthfully account for and pay over" said corporation's taxes.[43]

Mr. Bloom turned over the corporation's books and records to the Collector of Internal Revenue in Seattle, sometime in 1949.[44] He has never denied the corporation's tax liability for the withholding and F.I.C.A. taxes. He has consistently maintained, however, that neither he nor his wife is a person who "*wilfully* failed to pay, collect or truthfully account for and pay over" the corporation's taxes.

Until the present trial, no hearing was ever had to determine whether they were such persons. When Mr. Bloom applied to the U. S. Tax Court for the purpose of the abatement of these taxes, which he maintains were wrongfully assessed against him, the Tax Court dismissed the action on the ground that it did not have jurisdiction since the "assessment" represented a penalty and not a tax.[45]

The taxes which are the subject of this action were originally assessed against the corporation at various dates for the respective quarters, and such assessment dates run from April 9, 1948, to May 17, 1949. The

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[43]Complaint, paragraph 4.
[44]R.T. p. 103, lines 20-25.
[45]R.T. p. 145, lines 4-25; Exhibit V.

same taxes were thereafter purportedly "assessed" against Mr. and Mrs. Bloom on November 23, 1949.

However, it was not until November 18, 1955—more than six years after the last corporate assessment, that the action was commenced against Mr. and Mrs. Bloom.[46] In the meantime, tax liens had been filed against them as individuals, and warrants for distraint had been issued for the payment of the taxes by them and payment had been demanded of them—all despite the fact that no hearing had ever been had as to their responsibility for, or willfulness in not paying, the corporation's taxes.

The District Court, upon the trial, correctly held that there was not one scintilla of evidence as to Mrs. Bloom's liability for the corporation's taxes,[47] although for some years the tax liens had been of record against her, and rendered judgment in favor of Mrs. Bloom.

The trial Court and the Ninth Circuit Court of Appeals erred, as to both fact and law, however, in holding that Mr. Bloom is liable for such taxes, as will be more particularly shown in the argument. Wilfullness is a mixed question of law and fact; there are no contradictions in the record of Mr. Bloom's testimony.

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[46]R.T. p. 25, line 22 thru p. 26, line 3.

[47]R.T. p. 150, lines 22-23; p. 151, lines 19-20, appendix judgment.

QUESTIONS PRESENTED AND HOW RAISED.

A pretrial order was made and entered on November 20, 1957. It disposed of certain issues of fact raised by plaintiff's complaint and petitioners' answer thereto, and left the following questions of law and fact in issue:

(1) Whether the defendants willfully failed to pay the tax as defined by Section 2707(a), Internal Revenue Code of 1939, and whether they were persons required to collect, truthfully account for and pay over the tax imposed?

(2) Whether the plaintiff's claim, if any, is barred by the statute of limitations?

(3) Whether there are other credits or offsets besides those referred to in paragraph 5 of the complaint?

(4) Whether Section 2707(a) of the Internal Revenue Code of 1939 is a penal statute or a tax statute?

(5) Whether Section 2707(a) is unconstitutional and void as applied to the petitioners, as a violation of Amendments V, VII, and VIII of the United States Constitution or any of said Amendments?

At the trial, at the close of plaintiff's case, a motion to dismiss was made on behalf of petitioners. Said motion was renewed at the conclusion of the trial, at which time a motion for judgment for petitioners was also made.[48] Said motions were denied[49] as to appellant.

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[48]R.T. p. 26, line 5 thru p. 34, line 16; p. 149, line 23 thru p. 150, line 17.

[49]R.T. p. 38, lines 7-8; p. 151, lines 13-14.

SPECIFICATION OF ERRORS.

1. The District Court erred in denying petitioners' motion to dismiss, duly made at the close of the government's case and in denying petitioner's motion for judgment.[50] Said motions were based on two principal grounds: (a) that plaintiff government had neither alleged nor proved that petitioners willfully failed to pay the corporation's taxes, and (b) that the action was barred by the statute of limitations since more than six years had elapsed between the date of the assessment of the taxes on the corporation and the commencement of this action.

2. It further erred in making the following Findings of Fact:[51]

Finding No. 5: ". . . on November 23, 1949, the Commissioner of Internal Revenue *duly* assessed against the defendants Edward J. Bloom and Helen Bloom pursuant to Section 2707(a) Internal Revenue Code of 1939, the following taxes:

Taxable Period Ending	Type of Tax Underlying the Assessment	Amount of Assessments
12-31-47	FICA taxes	$ 119.16
3-31-48	FICA taxes	753.66
12-31-48	FICA taxes	97.98
12-31-47	Withholding taxes	4,662.10
3-31-48	Withholding taxes	3,858.85
6-30-48	Withholding taxes	2,195.20
9-30-48	Withholding taxes	1,041.40
12-31-48	Withholding taxes	720.10
		$13,448.45"

[50] R.T. p. 26, line 5 thru p. 34, line 16; p. 149, line 23 thru p. 150, line 4.

[51] See Findings of Fact and Conclusions of Law.

Finding No. 14: "The defendant Edward J. Bloom was the responsible officer of the Idaho Smelting, Inc. whose duty it was to collect, account for and pay over to the Internal Revenue Service the Withholding and FICA taxes of Idaho Smelting, Inc."

Finding No. 15: "Edward J. Bloom *willfully* failed to collect, pay over the Withholding and FICA taxes of Idaho Smelting, Inc."

3. It further erred in failing to make petitioner's requested Special Findings of Fact,[52] particularly the following:

"XV. No act of the defendant alleged or proved violated any legal obligation of defendant to plaintiff."

"XVI. Defendant's failure to pay the corporation's taxes was not without reasonable cause; it was not capricious or voluntary; defendant had no evil motive, lack of justification, or bad purpose."

"XVII. Defendant did not willfully fail to pay, collect, or account for and pay over any taxes imposed on the corporation."

"XVIII. The present action was not commenced until more than six years after the assessments for the withheld income taxes and the F.I.C.A. taxes were made against Idaho Smelting, Inc., and the statute of limitations had already run against the corporation before the present action was filed."

"XIX. The Court takes judicial notice of the file and judgment in Docket 27401 (Ex. V) estab-

[52]See Defendant's Proposed Findings of Fact.

lishing that this is a penalty against the defendant and not a tax, and that question is res adjudicata." (Tax Court of the U.S.)

4. It also erred in drawing the following Conclusions of Law.

Conclusion No. 4: "The defendant Edward J. Bloom *willfully* failed to collect, account for and pay over the Withholding taxes of Idaho Smelting, Inc., for the fourth quarter of 1947 and the first, second, third and fourth quarters of 1948."

Conclusion No. 5: "The defendant Edward J. Bloom *willfully* failed to collect, account for and pay over the FICA taxes of Idaho Smelting, Inc., for the fourth quarter 1947, first quarter 1948 and fourth quarter 1948."

Conclusion No. 6: "Edward J. Bloom was *the person* under a duty to collect, account for and pay over to Internal Revenue Service the Withholding and FICA taxes of Idaho Smelting, Inc."

Conclusion No. 8: "The United States instituted the within proceedings in court within six years after the assessment of the tax and said cause is not barred by the statute of limitations."

Conclusion No. 9: "Section 2707(a) is not unconstitutional as a violation of Amendments V, VII or VIII of the United States Constitution."

Conclusion No. 10: "The United States is entitled to a judgment against the defendant Edward J. Bloom in the sum of $19,292.79, plus accrued interest at the rate of 6% thereon, until paid."

The District Court had jurisdiction under Sections 7402 and 7403 of the Internal Revenue Code of 1954.

REASONS FOR GRANTING THE WRIT.

Unless this Court grants a Writ of Certiorari to the Court of Appeals for the Ninth Circuit, the following remarkable propositions of law will have been established and will doubtless be followed and reiterated in the future in regard to various matters of vital importance in the administration of Federal tax laws:

1. That a penalty providing for the secondary liability of an officer of a corporation may be enforced against him even though the primary liability, from which the other derives, is barred by the statute of limitations.

2. That the Internal Revenue Code of the United States provides *more* rights to the government and *less* rights to the individual taxpayer in cases involving *penalties* than in cases relating to the *taxes* themselves.

3. That an individual may be subjected to *penalties* for "*willfully*" failing to pay taxes owed, not by him, but by a corporation of which he is an officer, in spite of the fact that the corporation was operated on a trust receipts basis (millions of dollars of business transactions are similarly handled each year) and had *no* title to or control over the disposition of funds entrusted to it.

4. That an individual may be subjected to *penalties* for "*willfully*" refusing to utilize trust funds to pay corporation taxes, which funds it holds in trust under the Uniform Trust Receipts Act, even though, had he done so, he would have been *guilty of a*

felony and subject to *fine* and *imprisonment* under the criminal laws of the State of Washington.

The Supreme Court has never before, to petitioner's knowledge, had the opportunity of passing upon the questions raised by this petition, although they involve important issues of law.

ARGUMENT.

I. THE DISTRICT COURT ERRED IN DENYING PETITIONER'S MOTION TO DISMISS, FOR TAXING ACTS, INCLUDING PERIODS OF LIMITATION EMBODIED THEREIN, MUST BE CONSTRUED LIBERALLY IN FAVOR OF THE TAXPAYER, AND SINCE THE PERIOD OF LIMITATION HAD RUN IN FAVOR OF THE CORPORATION, IT HAD RUN IN FAVOR OF PETITIONER HERE.

It is well established law that taxing acts, including provisions of limitation embodied therein, must be construed liberally in the taxpayer's favor. *United States v. Updike*, 281 U.S. 489, 50 S. Ct. 367 (1930). That principle is particularly applicable to the instant case, in view of the very severe nature of the penalty under Section 2707(a).

It was stipulated at the trial[8] that the present action was not commenced until more than six years after the assessments for the withheld income taxes and FICA taxes had been made against the corporation, Idaho Smelting, Inc. And an action against the corporation for the collection of these taxes was, therefore, obviously barred.

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[8] R.T. p. 19, line 24 thru p. 20, line 2.

A careful reading of Section 2707(a) leads to the conclusion that its purpose, although penal in nature, is not to punish, but rather to secure the collection of a fund that has passed into the hands of the employer or, in the case of a corporate employer, a fund that has passed into the hands of a corporate officer who is responsible for accounting for and paying over said taxes to the Government. Such funds have been held to be in the nature of trust funds, the employer acting as a collecting agent for the United States. Obviously, the Government does not intend to collect the tax twice, from both the corporation and the officer. The effect of Section 2707(a) is simply to make the responsible officer personally and secondarily liable for the tax for which the corporation is primarily liable. In a very real sense the tax assessed against the corporation and the penalty purportedly assessed against the Blooms represent the same debt to the Government. The tax imposed upon the corporation is the basis of the liability, whether sought to be enforced directly against the corporation or by suit against the Blooms. If Mr. Bloom, therefore, does come within Section 2707(a), he does so as a person secondarily liable in the event the corporation does not pay.

It follows, therefore, that since the six-year statute of limitations barred the Government from suing on the primary obligation, the secondary liability of the Blooms, if any, was also extinguished. Or, in other words, if the period of limitation had run in favor of the corporation, it had run in favor of the Blooms.

In *United States v. Updike*, 281 U.S. 489, 50 S. Ct. 367, the Government brought suit against stockholders to recover unpaid income and excess profits taxes assessed against a dissolved corporation, on the theory that the assets of the corporation which were distributed to the stockholders, to the extent of such tax, became trust funds received to the use of the United States. The Supreme Court held that the action was barred since it was not brought within six years after the assessment of the tax against the corporation; that if the period of limitation had run in favor of the corporation it had run in favor of the transferees. Here Bloom was not even a transferee; the government never contended that any corporate funds passed to Mr. Bloom.

If Section 2707(a) is, in accordance with the established law cited above, construed liberally in favor of the taxpayer, it is clear that as a matter of law the Court erred in denying petitioner's motion to dismiss on the ground that the action was barred by the statute of limitations, and in refusing to make Defendant's Proposed Finding XVIII, and that judgment should be rendered for petitioner here.

II. THE ASSESSMENT OF A PENALTY WITHOUT NOTICE, HEARING, OR OPPORTUNTY FOR PETITIONER TO OFFER ANY FACTS IN SUBSTANTIATION OF HIS POSITION DEPRIVED PETITIONER OF DUE PROCESS OF LAW AND WAS AN ARBITRARY AND CAPRICIOUS EXERCISE OF THE TAXING POWER IN VIOLATION OF THE FIFTH AND SEVENTH AMENDMENTS OF THE UNITED STATES CONSTITUTION.

Throughout the course of the proceedings below the government was unable to cite a single case (and petitioner knows of none) to the effect that an assessment of a *penalty* (as distinguished from a tax) is to be deemed to be *prima facie* correct in an action in which the government is the plaintiff. Yet the government neither alleged, nor presented, any evidence to the effect that the petitioner was the person who had a duty to perform the act (payment of taxes) which allegedly constituted a violation of Section 2707(a) and 2707(d), or that he willfully failed to pay, collect, or truthfully account for and pay over the tax imposed on the corporation. The government simply contended that the fact that an *ex parte* assessment had been made against the petitioner was sufficient to establish a *prima facie* case against him (R. pp. 35-38) and that it was then up to the petitioner, the *defendant* in a *civil* case, to *prove* a *lack* of duty and a *lack* of willfulness. Such a contention is directly opposed to the elementary proposition that any plaintiff—even the United States Government—must plead and prove all elements of its cause of action.

This unprecedented contention by the government is made even more shocking by two further considerations: First, at the end of the case the District Court ruled, *and the government conceded*, that not

a *scintilla* of evidence had been produced which would impose *any liability whatsoever* upon Mrs. Bloom, who had been simultaneously assessed and sued with her husband. Now, if the bare fact of the assessment concededly did not constitute a "scintilla" of evidence against *Mrs.* Bloom, how could it be any more against *Mr.* Bloom?

Secondly, the Ninth Circuit in its opinion stated that Mr. Bloom had not been deprived of due process as he had not been adjudged liable for the taxes by the assessment alone, but only after trial in Court. (272 F. 2d at page 215.) This proposition might be given some credence were it not for the fact that the government steadfastly maintained that *solely* by virtue of an *ex parte* assessment of a *penalty* it had the right, not only to *lien*, but to *issue warrants for distraint* (three were issued against Mr. Bloom) against property and to sell such property—all without any opportunity for the citizen to so much as protest unless he were in a financial position to pay the entire tax and then sue for a refund. (R. 34.) Unfortunately, Mr. and Mrs. Bloom were not financially able to do so after the liquidation of the corporation to meet its trust obligations to the bank.

THE TRUST RECEIPT QUESTION.

On page 10 of the 9th Court of Appeals opinion they rely on the recent decision in *Wilson v. U.S.*, 250 F. 2d 312. The distinction which we argue the Court has missed entirely in its opinion is just this:

"Appellant (petitioner here) was chief executive officer of the corporation. It was his responsibility to determine how *corporate* funds should be expended." But the uncontradicted testimony was that all of the money in corporate accounts was trust money, i.e., money released to appellant and Idaho Smelting, Inc., under the Uniform Trust Receipts Act. Over such funds appellant or the corporation of which he was chief executive officer had no control whatever. Further to divest the corporation of any capacity to exercise *any* judgment or election as to what bills should be paid and when, the record shows that the bank extended overdrafts to Idaho Smelting up to $54,000 monthly and that overdrafts (i.e. the absence of any funds in the corporate accounts), extended throughout the latter part of 1947 and all of 1948. (Exhibit K.)

It is apparent from examination of Exhibit K that no funds were actually collected and withheld by Idaho Smelting Inc., or appellant, and that the tax returns made were computations of the tax that should be paid from the same source that paid the wages. Since this source was an overdraft, no actual money was in the hands of Idaho Smelting, Inc., or appellant, and it is uncontradicted that the bank would have had to approve and pay such an overdraft, and that they failed to do so. If there was occasionally a few dollars it was covered by a trust receipt and belonged to the bank. There can be no contradiction of appellant's positive testimony that the bank refused to authorize such an overdraft by

the bank officers' testimony that they had destroyed all their records and had no personal recollection of such refusal.

Therefore the Court of Appeals' opinion that there is any conflict whatever in the testimony is wholly incorrect in the light of the whole record and its exhibits, and the opinion of the trial Court is clearly erroneous as a matter of law.

By the terms of this decision, appellant is found liable for a penalty under the Internal Revenue laws for *not* doing something (paying corporate withholding taxes) when by the laws of the State of Washington he would have been *criminally* liable for a prosecution for embezzlement if he had done so from proceeds of trust receipt financing.

Such is not and cannot be the law. Surely the taxpayer-citizen must have some means of engaging in legal business activity under time-honored trust receipt methods of financing without being forced to choose between the Scylla of personal income tax penalties for corporate obligations and the Charybdis of state criminal prosecution.

The Court correctly states on page 2 of its opinion that

> "The terms of the financing agreement . . . required the Corporation to buy and sell aluminum on a trust receipt basis." (See also Exhibits A, B & C.)

The entruster's (bank's) interest in a trust receipt transaction is a property interest unaffected by Fed-

eral tax liens or attachment liens against property of the trustee. The object of the Uniform Trust Receipt Act is to standardize and protect the trust receipt method of financing the acquisition and resale of goods in their journey from producer to retailer. See headnotes 6 and 10, *Commercial Credit v. Bosse*, 283 P. 2d 937, and text. The deposit of proceeds to the account of the corporation did not change the trust character or deprive the entruster of its rights therein. Entruster's interest in the proceeds is a property interest and not a lien. *Commercial Credit v. Bosse, supra.*

The Court's attention is also called to Judge Hamley's opinion in *Maulding v. U. S.*, 257 Fed. 2d 56 and cases cited therein, for further definitions and explanations of trust receipt transactions.

Appellant submits that the Court correctly found that Idaho Smelting, Inc., was engaged in the aluminum business on a trust receipts method of financing but failed to consider fully the legal, fiduciary, trust, and economic factors arising out of that relationship. A standard form of the trust receipt used by Idaho Smelting is incorporated in this petition as Exhibit "D". The specific provisions of this document, binding upon Idaho Smelting, Inc., and the petitioner as an officer and director are as follows:

Trust Receipt

The undersigned (hereinafter called the "Trustee" within the meaning of the term as defined by the Uniform Trust Receipts Act of the State

of Washington) hereby acknowledges receipt from, and the holding in trust for, Seattle Trust and Savings Bank of Seattle (hereinafter called the "Entruster" within the meaning of the term as defined by the Uniform Trust Receipts Act of the State of Washington), of the goods, documents and/or instruments specified below, and agrees and acknowledges that a security interest in said goods, documents and/or instruments, and in any goods represented by said documents and/or instruments, remains in, or will remain in, or has passed to, or will pass to, the Entruster. Said goods, documents and/or instruments secure an indebtedness . . . owing to Seattle Trust and Savings Bank of Seattle, at its Main Branch, together with interest thereon in accordance with the terms of the credit, agreements, draft or note evidencing said loan and all indebtedness for which the goods, documents, or instruments hereinbelow described, or any of them, were security before the trust receipt transaction evidenced by this instrument. . . .

. . . In consideration of such receipt and other valuable conside ations, the Trustee agrees to hold said goods, documents and/or instruments in trust for the Entruster and subject to its security interest, to be used promptly by the Trustee without expense to the Entruster for the following purpose(s) check below but for no other purpose(s) and without liberty to hypothecate, mortgage, pledge assign or make any other disposition of the same or, unless hereinafter expressly provided, to sell the same:

1. To transfer to carrier.

2. To transfer to warehouse.

3. To deliver said goods to . . . who have/has agreed to purchase the same.

4. To sell said goods, subject to the following limitations (if any).

5. To manufacture or process said goods and to sell the same, whether or not manufactured or processed.

6. *

The Trustee agrees to account by delivering to the Entruster immediately upon receipt thereof by the Trustee, . . .

. . . The Entruster shall have full power to compromise and collect such proceeds in its own name or that of the Trustee. *The Trustee agrees that all proceeds* of the sale or exchange of said goods, documents and/or instruments or any of them, if, as, and when said proceeds are received by Trustee, *shall be held by the Trustee in trust for the benefit of the Entruster and the Trustee agrees to promptly account and pay to the Entruster all of said proceeds. . . .*

The Trustee agrees to pay all expenses and charges in connection with said goods, documents, instruments and any proceeds thereof, and will at all times while the same are in its hands hold said goods, documents, instruments *and proceeds* separate and distinct from any property of the Trustee and capable of identification and will definitely show such separation in all its records and entries. . . . The Entruster shall have the same security interest in any additions or improvements to goods as it had in the goods themselves. . . .

The Trustee agrees to deliver to the Entruster, on demand, accurate records and copies of all

accounts with respect to said goods, documents, instruments *or proceeds thereof* and to execute any assignments or other documents in connection therewith which the Entruster may require, and *the Trustee further agrees that there will be no offsets or credits against any claims or accounts constituting proceeds of said goods,* documents or instruments and guarantees payment of said claims and accounts in full.

. . . No waiver of any rights or powers of the Entruster or consent by it shall be valid unless in writing signed by the Entruster. No waiver of any existing default shall be deemed to waive any subsequent default, and all rights hereunder are cumulative, and not alternative, and are in addition to any rights given by law to the Entruster. In the event that the Trustee may have other trust receipt transactions with the Entruster, the default of the Trustee in the payment of any obligations to said Entruster secured by this or any other trust receipt transaction, will cause all indebtedness of the said Trustee to said Entruster, at the option of the Entruster and without notice to the Trustee, to become due and payable, irrespective of any maturity dates provided for in the obligations evidencing said indebtedness.

From the above terms, it is obvious that Idaho Smelting, Inc., and the petitioner had no leeway—no discretion—as to the use or control of the funds of the bank released to it in trust and on deposit in the account of Idaho Smelting, Inc., in occasional liquidation of the overdrafts without the express consent of the bank. And, as is amply borne out by the

record, throughout 1948 the bank was primarily, if not solely, interested in satisfying the corporation's liabilities to it. (Exhibit L.) The Court of Appeals implies on page 9 of its opinion that funds *were* available for the payment of these taxes and that the bank would have approved the payment of them if only so requested by the corporation. On the contrary, the entire course of the corporation's affairs from September, 1947, as revealed by the documentary evidence (Exhibits L, M, N, O and U), and the uncontradicted testimony of petitioner (T. R. pp. 79 et seq.), the bank officials (Depositions of Baillargeon and Winslow) and the corporation's officers (Depositions of Salyer and Thompson) discloses that the bank was justifiably concerned about the substantial loans outstanding which had been jeopardized by the collapse of the metal market; that pressure was thereupon placed upon the corporation to liquidate its large inventory held under trust receipt at depressed prices; that they persuaded other creditors to accept debentures rather than cash; and that the petitioner much later attempted to "bail out" the corporation through use of his personal funds even though he was not obligated to do so. There is no place in the record where there is any concession by any witness that funds in corporate accounts or control were not covered by trust receipts.

The entruster's (bank's) interest in a trust receipt is an absolute property right; at all times pertinent to the withholding taxes in question the bank actually had *title* to the funds of the corporation (see Exhibit

"D"). The corporation itself was merely a trustee for the bank, and could take no action concerning such funds without the bank's consent. The bank's interest in the funds was absolutely unaffected by the existence of Federal tax liens or attachment liens against the property of the trustee.

In *General Motors Acceptance Corporation v. Kline*,[1a] held that title to the property held under trust receipts was in the financing institution, and that the legal effect of the trust receipt is to be determined by state law.

The Supreme Court of Idaho, *Commercial Credit Corporation v. Bosse*[2a] (in which the United States, among others, appealed from a judgment in favor of the entruster) stated on page 939:

> "Appellant, United States of America, does not contend that it had a (income and withholding) tax lien on the automobile superior to the rights of respondent."

The Court then held:

> "Having determined that the security interest of respondent in the funds held by appellant sheriff is a property right, it follows that respondent was entitled to maintain its action in claim and delivery to recover such proceeds. Such property right was at all times present in such proceeds and is unaffected by any of the tax liens or attachment liens of appellants against the property of Bosse Motor, Inc."[3a]

[1a] 78 F.2d 618 (CCA 9th, 1935).

[2a] 283 P.2d 937 (1955).

[3a] *Id.* at p. 941.

As an officer of Idaho Smelting, Inc., the petitioner was in a fiduciary position in relation to the bank. If he had taken it upon himself to disburse the *bank's funds*—and all of the income of the corporation was such during this period—then he would have been liable, both civilly and criminally for this misappropriation and embezzlement. (Under Washington statutes, R.C.W. 9.54.010, a trustee may be imprisoned for just such an act of larceny.) Petitioner was not privileged by his position as president of the company to take funds *belonging to someone else* and apply them to corporate debts any more than any other trustee, guardian, or executor. Once this basic fact of trust receipt financing is acknowledged, it is obvious that the judgment appealed from is clearly incorrect on two grounds.

First, that petitioner was not, and could not have been under the circumstances, the "person" whose duty it was to account for and pay over the corporation's taxes when he had no control over the disbursements.

Secondly, the corporation's and petitioner's legal rights and obligations under this trust receipt system of financing preclude any conceivable holding that appellant "wilfully" failed to pay such taxes within the meaning of Section 2707(a).

How may a person be penalized for "wilfully" failing to pay taxes when he not only did not *own* the funds allegedly available to pay them or have any power or authority to disburse them, except as

checked by the terms of the trust receipt, but also would have been guilty of a breach of an express fiduciary relationship and criminally liable for larceny if he had done so?

Obviously, if petitioner had turned the entire corporation over to the bank at the time the withholding taxes were first unpaid, or if the corporation had elected to undergo bankruptcy, no question would arise of petitioner's liability now. He is now being penalized for this error in judgment in attempting to weather out the depressed metal market of the late 1940's in the hope that after his trust obligations to the bank had been satisfied, he would be able to reactivate the enterprise and make good the corporation's debts to the government and other creditors. If petitioner had used *corporate* funds for other purposes than taxes, that election so to do might subject him under current cases to penalty; but use of the bank's trust funds in the corporation account is NOT in any sense the same thing as the use of "corporate" funds. See *Commercial Credit Co. v. Bosse*, 283 P. 2d 937, 941, supra.

Although petitioner raised timely objections during the trial and stressed the penalty nature of this proceeding by the government in his brief the Court of Appeals did not consider in its opinion the serious constitutional question of the manner in which the penalty was imposed in this case. As previously stated appellant sought to obtain a hearing in the Tax Court after the assessment in question had been levied. That Court dismissed his petition, with the opinion

that the matter in suit was a penalty over which the Tax Court had no jurisdiction. (Exhibit V.)

As petitioner was not financially able to pay this penalty and then sue for a refund, his two District Court suits having been dismissed, he had no way of challenging or removing the liens against him until the government instituted this suit over six years later. The facts are undisputed and the government does not challenge appellant's statement that it relied upon its arbitrary *penalty* assessment made without notice or opportunity of a hearing—as establishing a *prima facie* case, thereby shifting completely the burden of proof to the appellant. Certainly there is no question but that appellant was prejudiced by the trial Court's denial of his motion to dismiss based on such grounds, in a case involving disputed issues of fact. Both the above mentioned tax Court decision (Exhibit V) and *Enochs v. Green*[4a] recognize that the amounts involved here are a *penalty*, rather than a *tax*.[5a] Respondent has cited no authority in the Code, Regulations, or case law—and appellant knows of none—which stands for the proposition that a mere *assessment* of a *penalty* is sufficient to establish a *prima facie* case for the Government. See also the minority opinion in *Enochs v. Green, supra.*

[4a]270 F. 2d 558 (C.C.A. 5th, 1959).

[5a]This is doubtless the reason the Government brought suit against appellant, rather than proceeding by way of distraint or jeopardy assessment.

III. THE DISTRICT AND CIRCUIT COURTS APPLIED ERRONEOUS AND IMPROPER STANDARDS OF LAW IN MAKING THEIR FINDINGS THAT PETITIONER WAS THE RESPONSIBLE OFFICER WHOSE DUTY IT WAS TO COLLECT, ACCOUNT FOR, AND PAY OVER THE CORPORATION'S TAXES AND THAT HE "WILLFULLY" FAILED TO COLLECT AND PAY OVER THE CORPORATION'S TAXES. THE TERM "WILLFULLY" AS USED IN SECTION 2707(a) MEANS "WITHOUT REASONABLE CAUSE", AND THE BASIC ELEMENTS OF WILLFULNESS ARE EVIL MOTIVE, LACK OF JUSTIFICATION, BAD PURPOSE, OR SOMETHING DONE OR NOT DONE WITHOUT JUSTIFIABLE EXCUSE.

In making its finding that Petitioner "willfully" failed to collect and pay over the corporation's taxes, the Courts below erroneously failed to consider that Section 2707(a) of the Internal Revenue Code is a penalty statute; that the term "willfully" as used in said section means "without reasonable cause," and that said term is used to characterize purpose of motive as distinguished from knowledge and intention.

The District Court improperly held that the mere fact that Mr. Bloom was the president of the corporation and the principal shareholder and knew that the payments did not accompany the corporation's tax returns, established his responsibility to see that the corporation's taxes were paid and that since he had knowledge that payments did not accompany the corporation's tax returns he had willfully failed to pay said taxes; that his motive or intent had nothing to do with the issue. Obviously, such a standard for determining "willfulness" is incorrect, and it has been so held in the case of *Cushman v. Wood*, 149 F. Supp. 644 (District Court, Arizona, May, 1956). This is

even more obvious when it appears that all funds of the corporation were trust funds released to it under the trust receipt act.

The *Cushman* case was an action for refund of moneys paid by plaintiffs as a penalty assessment made under the purported authority of Section 2707(a) for unpaid F.I.C.A. and withholding taxes of a corporation of which they were shareholders and officers. The Court held that plaintiffs were not the persons under a duty to pay the corporation's taxes since they were not the disbursing officers and also that their failure to pay over the corporation's taxes was not willful. When called upon to determine the meaning of "willfulness" under Section 2707(a), the Court held as follows, at 149 F. Supp. 644, 646:

> "The term 'willfully' as used in Section 2707(a) means without reasonable cause. It is used to characterize purpose or motive as distinguished from knowledge and intention. Kellems v. United States, 50-2 USTC par. 9489; 42 AFTR 1351. The interpretation is basically the same as is assigned to the word when it is used in a statute establishing certain conduct as being criminal. United States v. Murdock, 290 U.S. 389, 54 S. Ct. 223, 78 L. Ed. 381; Spies v. United States, 317 U. S. 492, 63 S. Ct. 364, 87 L. Ed. 418; United States v. La Fontaine, D.C., 54 F. 2d 371. Thus, the basic elements of willfulness are evil motive, lack of justification, bad purpose, or something done or not done without justifiable excuse.
>
> "This interpretation of the word 'willfully' is consonant with that applied by the courts to

willful conduct which is punished by a civil penalty. Felton v. United States, 96 U.S. 699, 24 L. Ed. 875; Carson Naval Stores Co. v. United States, D.C., 29 F. Supp. 818; West Side Tennis Club v. Commissioner, 2 Cir., 111 F. 2d 6, 130 A.L.R. 103; One 1941 Buick Sedan etc. v. United States, 10 Cir., 158 F. 2d 445.

"Just as U.S. District Judge Hincks concluded in Kellems v. United States, supra, this view of the scope of the word 'willfully' is buttressed by the very severe nature of the penalty set forth in Section 2707(a). It is twice as harsh as the penalty for a fraudulent return established by Section 3612 (d) (2). And, as Judge Hincks also noted, when the penalty provided in Section 3612 (d) (1) for failure to file a return does not apply when such failure is due to reasonable cause, it cannot easily be inferred that Congress intended to subject a taxpayer to a penalty twice as severe in a case where there exists reasonable cause for a failure to comply."

Felton v. United States, 96 U.S. 699, 24 L. Ed. 875 (1878), cited in the *Cushman* case, *supra,* was an action brought by the United States against certain distillers of spirits to recover a penalty of $1000 prescribed by a certain Act of 1868 imposing taxes on distilled spirits, on the alleged ground that the defendants "knowingly and willfully" omitted, neglected and refused to construct and maintain certain pipes and other apparatus in the manner required by the statute. On the trial, the Court refused defendants' request to give a certain instruction regarding willfulness; the jury rendered a verdict for

the Government, but accompanied it with a finding that there was only a technical violation of the law, and that there was clearly no intent to defraud the Government thereby. Judgment having been entered upon the verdict, the case went to the United States Supreme Court on a writ of error, and the Supreme Court reversed the judgment. In the opinion of the Court, Mr. Justice Field stated (24 L. Ed. 876):

> ". . . (the evidence) showed their ignorance of the defect until it was too late to remedy it for the distillation that was taking place. There was, therefore, the absence of that knowledge which could render the neglect willful, and therefore actionable. They must have 'knowingly and willfully' omitted to furnish a receiver of sufficient capacity before the severe penalty prescribed could be imposed upon them and their distilled spirits subjected to forfeiture. Doing or omitting to do a thing knowingly and willfully, implies not only a knowledge of the thing, but a determination with a bad intent to do it, or to omit doing it. 'The word "willfully" said Chief Justice Shaw, 'in the ordinary sense in which it is used in statutes, means not merely "voluntary" but with a bad purpose.' Com. v. Kneeland, 20 Pick. 220. 'It is frequently understood,' says Bishop, 'as signifying an evil intent without justifiable excuse.' Cr. L., Vol. I, sec. 428."
>
> ". . . All punitive legislation contemplates some relation between guilt and punishment. To inflict the latter where the former does not exist would shock the sense of justice of everyone."

If the proper standards of law are applied, in light of the facts of this case, it is clear that the petitioner,

Edward J. Bloom, was not the person under the duty to pay the corporation's taxes, and that, as a matter of law, his conduct was not willful insofar as any failure to collect, or truthfully account for, or pay over the Withholding Taxes and the F.I.C.A. Taxes is concerned.

IV. THE DISTRICT COURT ERRED IN DENYING DEFENDANTS' MOTIONS TO DISMISS AND FOR JUDGMENT, FOR THE GOVERNMENT DID NOT ALLEGE, OR OFFER ANY PROOF OF, DEFENDANTS' DUTY AND RESPONSIBILITY, OR THEIR "WILLFULNESS", WHICH ARE NECESSARY ELEMENTS OF THE PLAINTIFF'S CAUSE OF ACTION TO REDUCE TO JUDGMENT AN ASSESSMENT MADE AGAINST DEFENDANTS UNDER THE PURPORTED AUTHORITY OF SECTION 2707(a) OF THE INTERNAL REVENUE CODE OF 1939. THE ASSESSMENT OF THE PENALTY WITHOUT DUE PROCESS OF LAW WAS AN ARBITRARY AND CAPRICIOUS EXERCISE OF THE TAXING POWER AND CONSTITUTED A VIOLATION OF AMENDMENTS V, VII, AND VIII OF THE UNITED STATES CONSTITUTION.

At the close of the Government's case, a motion to dismiss was promptly made in behalf of the petitioners here on the ground that the Government had neither alleged nor proved a cause of action and on the further ground that the action was barred by the statute of limitations.[53] At the conclusion of the trial said motion was renewed, and a motion for judgment for Defendants (Petitioners here) was also made. Said motions were erroneously denied[54] as to appellant.

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[53]R.T. p. 26, line 5 thru p. 34, line 16.

[54]R.T. p. 151, lines 13-14.

It is elementary that the Plaintiff has the burden of proving its cause of action.

In an action to reduce to judgment an "assessment" made against Defendants under the purported authority of Section 2707(a) of the Internal Revenue Code of 1939, two essential elements of the cause of action are (1) that the defendants are persons who had a duty to perform the act in respect to which the violation occurred, and (2) that the defendants willfully failed to pay, collect, or truthfully account for and pay over the tax imposed on the corporation. (*Cushman v. Wood*, 149 F. Supp. 644.) Yet the Government as plaintiff neither alleged, nor presented, any evidence concerning these two elements. The Government simply contended that the fact that an "assessment" had been made against the Blooms was sufficient to establish a prima facie case against them, and that it was then up to the defendants to prove a lack of duty and a lack of willfulness. Such a contention shocks one's sense of justice, particularly in light of the facts of this case.

It is true that the Pretrial Order states that the assessment was made.[33] That means, simply, that a summary record was signed by an assessment officer in a district director's office. At no time have the defendants ever stipulated or agreed that the assessment was duly or regularly made.

Moreover, while a duly made assessment of a tax might be prima facie correct, the Government has

[33] Pretrial Order, par. 3.

not cited any case to the effect that an assessment of a penalty (as distinct from a tax) is to be deemed to be prima facie correct in an action where the Government is the plaintiff.

There is no evidence that any notice of the contemplated assessment against the Blooms was given prior to the purported assessment of the penalty.

An assessment of a *penalty* made by merely making a summary record in a district director's office, without first providing the person against whom the assessment of the penalty is made with notice or an opportunity to be heard, on its face appears to be a violation of due process of law. See *Steiner v. Nelson*, 259 F. 2d 853, 7th Cir. 1958.) This is a very serious violation, particularly in the instant case, where the penalty assessed was not for the nonpayment of the defendant's taxes but for the nonpayment of the taxes of another person, a corporation. Also, no adequate remedy was provided for a hearing subsequent to the assessment. The Tax Court refused to determine the matter on the grounds that it had no jurisdiction since the assessment was for a penalty and not a tax.[56]

The Government purportedly assessed the penalty of $13,448.45 against the Blooms on November 23, 1949,[57] but did not file this action until November 18, 1955.[58] In the meantime, of course, tax liens were

[56]R.T. p. 145, lines 12-24.
[57]R.T. p. 24, lines 9-12.
[58]R.T. p. 24, line 17.

placed of record against the defendants, in spite of the fact that their liability had not been finally fixed. The 6 year statute of limitations against the corporation expired in May, 1965 and it was so stipulated at the trial.

If the assessment is deemed to be of a tax and duly made and to establish a prima facie case against the petitioner obviously it is an arbitrary and capricious exercise of the taxing power, and as such constitutes a violation of Amendment V of the Constitution of the United States, which provides that no person shall be deprived of property without due process of law. Likewise, such a summary determination appears to deprive defendants of a jury trial, to which they are entitled by Amendment VII of the Constitution. And, furthermore, such an assessment appears to violate the provisions of Amendment VIII of the Constitution, which provides that excessive fines shall not be imposed, nor shall cruel and unusual punishments be inflicted.

The District Court contradicted itself in holding, on the one hand, that the motion to dismiss on the ground that the Government had failed to plead or prove its cause of action should be denied, and on the other hand, holding that there was not one scintilla of evidence tending to hold Mrs. Bloom liable.[39] If the fact of the assessment constituted no evidence at all against Mrs. Bloom, it likewise constituted none against Mr.

[39] R.T. p. 151, lines 13-14; p. 150, lines 22-23, judgment in appendix in favor of Mrs. Bloom.

Bloom, and the Court erred in denying petitioners' motion to dismiss.

From all of the foregoing, it appears obvious that if §2707(a) of the Internal Revenue Code of 1939 is construed, under these circumstances, to be a *penal* statute, then it is unconstitutional and void as sanctioning a denial of due process. On the other hand, if that section is construed to be a tax statute, then the Tax Court erred in refusing jurisdiction and the petitioner was, like other taxpayers, entitled to notice of deficiency as provided in Section 272(a) of said Code before an assessment could be validly levied.

V. THE EVIDENCE IS INSUFFICIENT TO SUPPORT THE FINDINGS THAT PETITIONER WAS THE "PERSON" WHOSE DUTY IT WAS TO COLLECT, ACCOUNT FOR, AND PAY OVER THE CORPORATION'S TAXES AND THAT HE "WILLFULLY" FAILED TO COLLECT AND PAY OVER THE CORPORATION'S TAXES, AND TO SUSTAIN THE JUDGMENT AGAINST PETITIONER; AND THE JUDGMENT FOR GOVERNMENT SHOULD BE REVERSED.

There is insufficient evidence to support the finding that Mr. Bloom was the "person" within the meaning of Section 2707(a), charged with the duty of collecting, accounting for, and paying over the taxes of Idaho Smelting, Inc. The Government, who as plaintiff, had the burden of proof, offered no evidence at all on this issue.

It is true that Mr. Bloom was the principal stockholder,[61] and the president,[62] but he was traveling most

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[61] R.T. p. 66, lines 21-23.

[62] R.T. p. 66, lines 12-14.

of the time;[63] and he was not in charge of the administrative affairs of the corporation. The corporation's vice president and sales manager, W. H. Salyer[64] was the person in charge of the principal office in which the tax records were kept; and he and Mr. O'Brube, the manager of the smelter, exercised the functions of general management. Other officers in addition to Mr. Bloom were authorized to, and did, sign checks of the corporation.[65] Also the corporation employed a bookkeeper and accountant, and the services of certified public accountants, and relied on these people in so far as financial records and tax returns of the corporation were concerned.[66] It was Mr. Bloom's belief that the corporation was making money.[67]

In *Cushman v. Wood*, 149 F. Supp. 644, the Court held that the mere fact that an individual is an officer and a shareholder of a corporation does not mean that he falls within the meaning of "person" as used in Section 2707(a). To come within that section it appears that there must be a definite and specific duty on the part of the individual to perform the act in respect to which the violation occurs, such as that of a disbursing officer. Mr. Bloom was not the disbursing officer of the corporation. Before an officer can be charged with a duty to disburse funds of a corporation, it would seem that the corporation should make provision for that officer to have funds to dis-

[63]R.T. p. 62, line 20 thru p. 63, line 6.
[64]R.T. p. 63, lines 10-14.
[65]R.T. p. 64, lines 10-18.
[66]R.T. p. 67, lines 1-23.
[67]R.T. p. 123, lines 8-12.

burse. Mr. Bloom at no time had funds of the corporation under his control, over which he could exercise any discretion as to their application; any and all funds of the corporation which came into his possession had to be applied according to the trust direction, or with the approval, of the Seattle Trust and Savings Bank, which actually had control of all the corporation's finances by reason of the Loan Agreement, trust receipts, warehouse receipts, assignments of accounts receivable, and chattel mortgages. The Bank was, in a very real sense, the disbursing agent for the corporation, if anyone was.

Under the authority of *Cushman v. Wood, supra,* therefore, there is no evidence that Mr. Bloom is a "person" within the meaning of Section 2707(a).

Moreover, even if Mr. Bloom were the person charged with a duty to pay the corporation's taxes, the evidence shows that in this case he had no power at all to perform such a duty, and hence had a justifiable excuse for nonperformance.

The trust receipts transactions are undenied, and their effect is undisputed. (Exhibit D.) All funds received by the corporation arose out of transactions controlled by trust receipts executed prior to the receipt of the funds.

The corporation didn't have any funds to be applied at the discretion of itself or any of its officers, since the uncontradicted evidence is that all funds the corporation received were in trust for the Bank. (See Exhibit "D".)

Although the corporation's method of financing was involved and complex, there was nothing illegal or crooked about it, and nobody says there was! There is not one bit of evidence that Idaho Smelting, Inc., or Mr. Bloom, had an evil motive or bad purpose in not paying the corporation's taxes. Indeed, the Government itself admits there was no fraud or anything like that.[68]

The Government offered no evidence at all probative of Defendant's willfulness.

The evidence is undisputed that the corporation operated under a Loan Agreement with the Seattle Trust and Savings Bank, under which the Bank advanced funds upon trust receipts, warehouse receipts, and assignments of accounts receivable, and under which the Bank permitted certain overdrafts (according to the Canadian style of banking, common in the Northwest).[69]

Every transaction the corporation engaged in—whether a purchase or sale—was governed by either trust receipts, warehouse receipts, or agreements concerning assigned accounts receivable, and these latter transactions were also protected by trust receipts. Each transaction was subject to some such document, that placed the ownership and control of the funds in the hands of the Bank. Whenever the corporation received proceeds from the sale of its products, the funds came in under a trust receipt, and the funds

[68] R.T. p. 35, lines 19-20.
[69] R.T. p. 70, Lines 8-15.

belonged to, and had to be accounted for and paid over to, the Bank directly. And when the Bank advanced money for the purchase of inventory supplies, etc., it was only upon express agreement that the goods would be shipped on an order bill of lading to the Bank, who would release them only upon execution of trust receipts. No cash which passed into the hands of the corporation on either a purchase or sale transaction could be used for anything except the specific purpose directed or approved by the Bank under the terms of the trust receipts. The moneys constituted trust funds belonging to the Bank. The Bank was the boss, and any application of the funds except as permitted by the Bank would have amounted to embezzlement.[70]

Furthermore, the Bank, being the boss, was the party that decided which checks of the corporation would be honored on an overdraft basis.

The exhibits introduced in behalf of defendant abundantly support the foregoing argument that the Bank dominated the corporation.

Exhibits A, B, and C, the Loan Agreement, show that the Bank contracted to loan to Idaho Smelting, Inc., up to $849,000.00 upon the security of trust receipts, under the Uniform Trust Receipts Act of the State of Washington, or upon warehouse receipts,

[70]The Uniform Trust Receipts Act has been in effect in Washington since March 9, 1943, as R.C.W. 61.20.010 to 190. Embezzlement or misapplication of trust funds constitutes larceny under the laws of Washington, R.C.W. 9.54.010, punishable by imprisonment for 15 years.

which were also released to the corporation upon trust receipts.

Exhibit G, Notice to Secretary of State, shows that the corporation qualified under the Uniform Trust Receipts Act by giving the required notice to the Secretary of State.

Exhibit D, forms of Trust Receipts, shows the provisions of the trust receipts and that the Bank was to receive the money proceeds.

Exhibit F, a Resolution incorporating an agreement re assignment of accounts receivable, shows that the Seattle Trust and Savings Bank was in control, because the corporation contracted in June, 1947, not to do business with any other bank except it.

Exhibit K shows that overdrafts were permitted to the extent of $43,557.67 at one time in late 1947 on the general account, and to the extent of $3,000.00 at the same time by way of payroll account overdrafts. Such overdrafts were discharged by the Bank's application of funds derived from the trust receipts. As Exhibit K shows, this practice of financing by honoring overdrafts continued during the entire period over which the taxes accrued. Occasional credit balances shown in the account represented outstanding checks whose issuance had been authorized but which had not yet cleared. Bank witnesses, Cebert Baillargeon and K. Winslow, Jr., in their depositions, taken by the Government and offered by the Government solely as rebuttal evidence, admitted that extending overdraft privileges was part

of the regular policy of the Bank toward Idaho Smelting, Inc.[71]

Exhibit J shows, by way of illustration, certain interest charges in 1947 and 1948 for such overdrafts.

Pursuant to the Loan Agreement, loans were made on notes of the corporation. That these notes were not always signed by Bloom is illustrated by *Exhibit H.*

The uncontradicted evidence is that prior to 1948 the Bank always granted the corporation's request to pay taxes on an overdraft basis without delay.[72] It was not until on or about January 20, 1948, after the bulk of the corporation's taxes which are the subject of this suit had already accrued, that the Bank indicated there would be any change in its policy. Even then, the Bank did not say it would not advance funds for taxes or permit an overdraft for taxes. It simply said it would not do so just yet, but that the money would be available shortly if the corporation cooperated with the Bank.[73]

By that time Mr. Bloom had had what he considered friendly, pleasant, and successful relations with the Bank for more than a year and a half, and he and the corporation continued to rely on it for advice and assistance, with the belief that if the cor-

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[71]R.T. p. 146, line 4 thru p. 147, line 3; Deposition of Baillargeon, p. 12; Deposition of Winslow, p. 11, lines 10-16; p. 14, line 20 thru p. 15, line 3. Exhibit K.

[72]R.T. p. 58, line 24 thru p. 59, line 10; p. 111, lines 15-17; p. 78, lines 11-15.

[73]R.T. p. 125, lines 3-24; p. 83, line 17 thru p. 84, line 4.

poration followed the Bank's advice it would shortly be on its feet and the Bank would grant further credit to it, as the Bank had represented.

In reliance on the Bank's representations and advice, therefore, the corporation curtailed certain of its operations early in 1948 and continued certain other operations, and debenture bonds were issued. The corporation, largely through Mr. Bloom's efforts, had by the end of 1948 paid off the debt to the Bank in full. At that point, the Bank told Mr. Bloom that since the Government had filed tax liens against Idaho Smelting, Inc., the Bank didn't feel it could do any further business with the corporation and would grant no further credit to it.[74]

By then, of course, all the withheld income taxes and F.I.C.A. taxes of the corporation, Idaho Smelting, Inc., which are referred to in plaintiff's complaint, had accrued. It was obvious at last that the Bank had been liquidating the corporation for the Bank's sole benefit. The corporation now had neither money nor credit.

Under such circumstances, since Mr. Bloom had no corporate funds in his hands or under his control, he had no power at all to make a decision whether the corporation would or would not pay the taxes; he had no free will, no choice, no discretion, in that regard.

Mr. Bloom had not taken any corporate funds and diverted them to his own use. To the contrary, the evidence is that he expended his time, energy, and personal funds in an effort to pay the debenture

[74]R.T. p. 91, lines 14-19.

bonds and to preserve the corporation's interest in its real property, in order that the creditor's rights might be protected and the taxes paid. Clearly, Bloom had no evil motive, no lack of justification, no bad purpose. The failure to pay the corporation's taxes, under the facts of this case, cannot justly be considered intentional, deliberate, or voluntary.

This case is readily distinguishable from *In re Haynes,* 88 F. Supp. 379, which was a bankruptcy proceeding in which the United States filed claims for taxes against the bankrupt, who had been an officer of a corporation that did not pay over certain withheld income and social security taxes. In that case, the officer (the bankrupt) had had in his hands or under his control funds of the corporation that had been set apart for the purpose of paying the taxes but he had not paid them. In contrast, neither Idaho Smelting, Inc., nor Mr. Bloom as an officer thereof, ever had control at all over any corporate funds that could be lawfully used for the payment of such taxes.

The Court said, in the *Haynes* case, regarding Section 2707(a):

> "The purpose of this statute is not to punish but to secure the collection of a fund that has passed into the hands of the employer, which is in the nature of a trust fund, the employer acting as a collecting agency of the United States."

No such trust funds ever passed into the hands of Mr. Bloom, the defendant herein.

This case is also distinguishable from *Paddock v. Siemoneit,* 218 S.W. 2d 428, in which the trustee in bankruptcy for a corporation brought an action

against Siemoneit, the managing officer of the corporation, to subject a homestead to a constructive trust in favor of the corporation. The United States intervened in the suit, asking for a judgment for a penalty against Siemoneit under Section 2707(a). While the corporation was a going concern, it had become liable for Social Security and Withholding Taxes which Siemoneit did not pay when due because he thought and decided that the corporation would have a better chance to operate profitably if it postponed the payment of such taxes and used the money it had for other purposes. Also while the corporation was solvent, Siemoneit withdrew money in excess of the balance to his credit, and used such funds to purchase real property which he homesteaded.

But Mr. Bloom (in contrast to Mr. Siemoneit) never had any free choice to decide whether or not the corporation would pay its taxes, because from the time he first learned about the accrued taxes in January, 1948, until the corporation died, there never were any funds which the corporation could use for any purposes except those permitted by the Bank. Also Mr. Bloom never withdrew any funds from the corporation for himself, as Mr. Siemoneit did. To the contrary, Mr. Bloom advanced further funds in order to try to put the corporation on its feet so that it could make money and pay all its obligations.

In *Nugent v. United States,* 136 F. Supp. 875, the corporate officer merely showed that nonpayment of the taxes was premised upon pending litigation with the State of Wisconsin and subsequent insolvency; he did not show inability of the corporation to pay

the taxes prior to the insolvency or at the time they were due. But the evidence is uncontradicted, that Idaho Smelting, Inc., was unable to pay the taxes at the time they were due, and that Mr. Bloom was not responsible for its inability to pay.

In *Levy v. United States,* 140 F. Supp. 834, an action to recover the amount paid on a penalty assessment under Section 2707(a), the Court found that plaintiff taxpayer, where he did not know that the taxes of the corporation were due and unpaid until shortly before the corporation failed completely and at a time when it could not pay, "did not consciously or deliberately fail or refuse to have the taxes paid, although he may have been negligent in failing to maintain closer supervision over the affairs of the corporation," and held that he was entitled to the refund.

In *Wilson v. United States,* 250 F. 2d 312, 9 Cir. 1958, Mr. Justice Barnes cites *Cushman v. Wood,* 149 F. Supp. 644, as holding that mere intentional failure to pay the corporation's taxes is not sufficient to constitute willful failure to pay within the meaning of Section 2707(a). The *Wilson* case is cited in *United States v. Palermo,* 259 F. 2d 872, 3d Cir. 1958.

The discussions of "willfulness" in the *Wilson* and *Palermo* cases are of particular interest and application to the present action, in light of the holding in *Cushman v. Wood* that "The interpretation" of the term "willfully" as used in Section 2707(a) "is basically the same as is assigned to the word when it is used in a statute establishing certain conduct as being criminal."

When proper standards of law are applied to the facts of this case, it is obvious that the District Court erred in finding that defendant was a person who willfully failed to pay the corporation's taxes, in refusing to make the special findings requested by defendant, and in granting judgment for plaintiff.

CONCLUSION.

Petitioner respectfully submits that the documentary and oral evidence contained in the record abundantly and conclusively demonstrates that both of District Court and the Court of Appeals for the Ninth Circuit erred in their interpretation of Section 2707(a) of the Internal Revenue Code of 1939 and in finding that the petitioner was the "responsible officer" who "willfully" failed to pay the taxes of Idaho Smelting, Inc. That by reason of these matters and for all of the reasons set forth above, the writ should issue herein.

Wherefore, your petitioner prays that a writ of certiorari issue under the seal of this Court, to the end that this cause may be reviewed and determined by this Court as provided for by law; that the judgment of the said Court of Appeals for the Ninth Circuit be reversed; and for such other and further relief as to the Court may seem meet and proper.

Dated. March 3, 1960.

JAMES W. HARVEY,
Attorney for Petitioner.

DOROTHY E. HANDY,
CLARK A. BARRETT,
Of Counsel.

(Appendix Follows.)

Appendix

United States Court of Appeals
for the Ninth Circuit

EDWARD J. BLOOM, *Appellant,* vs. UNITED STATES OF AMERICA, *Appellee.*	No. 16,127 Nov. 2, 1959

On Appeal from the United States District Court for the Northern District of California, Southern Division.

Before: BARNES, HAMLEY and JERTBERG, Circuit Judges.

JERTBERG, Circuit Judge.

This is an appeal from a judgment against an officer of a corporation for the amount of income taxes and social security taxes withheld from wages of employees of the corporation but not paid over to the United States.

Jurisdiction was conferred on the district court by Title 28 U.S.C.A. Section 1345. This Court has jurisdiction under the provisions of Title 28 U.S.C.A. Section 1291.

The action was predicated on Section 2707(a) and Section 2707(d) of the Internal Revenue Code of

1939.[1] This section applies to social security taxes and withholding taxes by virtue of Sections 1430 and 1627 respectively of the Internal Revenue Code of 1939.

Appellant Edward J. Bloom, a licensed metallurgist, entered the aluminum smelting business in 1945 at the conclusion of his wartime service in the Navy. He formed and operated at that time the Idaho Company, an individual proprietorship, for the purpose of purchasing wrecked aircraft (chiefly from the War Assets Administration), making alumium alloy ingots from the scrap, and selling the ingots to foundries. To finance the operation of the Idaho Company, appellant relied on his own funds and those of friends and also borrowed extensively from the Seattle Trust and Savings Bank. During 1945 and 1946 the scrap aluminium business was extremely profitable. The business was incorporated in the State of Washington on or about July 1, 1946 as Idaho Smelting, Inc. All assets of the Idaho Company were transferred to

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[1] "Sec. 2707. Penalties.—

(a) Any person who willfully fails to pay, collect, or truthfully account for and pay over the tax imposed by section 2700(a) or willfully attempts in any manner to evade or defeat any such tax or the payment thereof, shall, in addition to other penalties provided by law, be liable to a penalty of the amount of the tax evaded, or not paid, collected, or accounted for and paid over, to be assessed and collected in the same manner as taxes are assessed and collected. No penalty shall be assessed under this subsection for any offense for which a penalty may be assessed under authority of section 3612.

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(d) The term 'person' as used in this section includes an officer or employee of a corporation, or a member or employee of a partnership, who as such officer, employee, or member is under a duty to perform the act in respect of which the violation occurs."

Idaho Smelting, Inc. Certain preferred stock was issued to persons who had individually lent money to appellant for his business, and 898 out of 900 shares of common stock were issued to appellant, who became president and chief executive officer of the new corporation.

Upon the formation of Idaho Smelting, Inc., the financing bank agreed to make the same financing arrangements with the corporation as had existed with the sole proprietorship, and with the adoption of the necessary corporate resolution, this was done. The agreement provided for the extension of credit up to the sum of $849,000, but the maximum ever extended was approximately $700,000. The terms of the financing agreement extended credit on an overdraft system of lending (sometimes referred to as the Canadian style of banking), and required the corporation to buy and sell aluminum on a trust receipts basis.

In September of 1947 the metal market dropped drastically. There was no longer a shortage of metal. Foundries did not want to stock large amounts, and Idaho Smelting, Inc. was left holding a large inventory for which there was no immediate demand. The organization remained in business, however, hoping to weather out the storm. Since the corporation was not making large sales, it could not meet its obligations to the bank promptly.

On or about January 20, 1948, the bank informed appellant by letter that "We are not at all satisfied with the progress which is being made to place the account of Idaho Smelting, Inc. on a satisfactory

basis," and gradually exerted pressure on the company to liquidate its inventory so as to insure that the bank would not suffer a loss on its loans. On January 31, 1948, when the corporation filed a tax return for the last quarter of 1947, for the first time it failed to include payment for the withheld income and social security taxes of that quarter. Throughout the remaining months of 1948, as the corporation continued to liquidate its inventory to satisfy the bank's demands, employees were paid a net amount excluding the withheld income and social security taxes, but none of the withheld taxes (with the exception of two quarters' social security taxes) were ever paid to the United States. Returns without payment were filed quarterly. The government assessed the delinquent taxes against the corporation for each quarter.[2] In July, 1948 tax liens were filed against the corporation by the government.

Many of the creditors of the corporation were induced to accept debenture bonds in place of their open account claims against the corporation, and bonds aggregating $106,000 in amount were issued, with the bank as trustee and paying agent for the coupons. By the middle of July, 1948, virtually all major creditors of the corporation had accepted debenture bonds. By December 31, 1948, with the liquidation process completed, all indebtedness to the bank had been discharged, and the corporation was practically without funds. There were then no paid employees of the

[2]The last assessment against the corporation was made May 17, 1949.

corporation. For all practical purposes the corporation was dead. Loans were sought from other banks, but primarily because of the outstanding tax liens filed against it, the corporation was unable to procure them.

On November 23, 1949, the Commissioner of Internal Revenue assessed against appellant and his wife certain taxes, aggregating $13,448.45, which represented the amount of delinquent withheld taxes originally assessed against the corporation, under the theory that they were "persons who had willfully failed to pay, collect, or truthfully account for and pay over" said withheld taxes. Notice and demand for payment was made. Warrants of distraint were issued, and tax liens were filed against them. Payment was refused, appellant and his wife contending that they did not willfully fail to pay the corporation's taxes, and that they were not the persons required to pay, collect, or truthfully account for and pay over the same. This action was brought on November 18, 1955, to reduce to judgment the above unpaid assessment. The trial court, without a jury, held that there was no evidence as to Mrs. Bloom's liability for the taxes, and rendered judgment in her favor. The trial court also held that "The defendant Edward J. Bloom was the responsible officer of the Idaho Smelting, Inc. whose duty it was to collect, account for and pay over to the Internal Revenue Service the withholding and F.I.C.A. taxes of Idaho Smelting, Inc." and concluded that "The defendant Edward J. Bloom willfully failed to collect, account for and

pay over the withholding taxes of Idaho Smelting, Inc. for the fourth quarter of 1947 and the first, second, third and fourth quarters of 1948" and "The defendant Edward J. Bloom willfully failed to collect, account for and pay over the F.I.C.A. taxes of Idaho Smelting, Inc. for the fourth quarter of 1947, first quarter of 1948 and fourth quarter of 1948."

On the basis of the findings of fact and conclusions of law, the trial court entered judgment for the United States against appellant for $19,292.79.

On this appeal appellant presents four contentions. They are:

First, that since the suit to reduce to judgment the assessment made against him was commenced almost seven years after the assessments had been duly made against the corporation, whatever claim the government may have against him individually has become outlawed under Section 3312 of the Internal Revenue Code of 1939,[3] which requires a suit to reduce an as-

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[3] "Sec. 3312. Period of Limitation Upon Assessment and Collection.

• • •

(a) General Rule.—All internal revenue taxes shall (except as provided in subsections (b), (c), and (d)) be assessed within four years after such taxes became due, and no proceeding in court without assessment for the collection of such taxes shall be begun after the expiration of five years after such taxes became due.

• • •

(d) Collection after Assessment.—Where the assessment of any tax imposed by this title has been made within the statutory period of limitation properly applicable thereto, such tax may be collected by distraint or by a proceeding in court, but only if begun—

(1) Within six years after the assessment of the tax, or

(2) Prior to the expiration of any period for collection agreed upon in writing by the Commissioner and the taxpayer."

sessment to judgment to be commenced within six years of the date of the assessment.[4]

Second, that since Section 2707(a) provides for a "penalty", the assessment of that penalty was without due process of law, was an arbitrary and capricious exercise of the taxing power and consequently constituted a violation of Amendments V, VII and VIII of the United States Constitution.

Third, that the trial court erred in holding that he was the responsible officer whose duty it was to collect, account for, and pay over the withheld taxes.

Fourth, that the trial court used an improper definition of "willfully" in concluding that appellant willfully failed to pay over and collect the said taxes.

Under the first contention, appellant argues that the tax sought to be collected from the corporate officer is the same tax sought to be collected originally from the corporation, and that, therefore, the government's claim is only that of a secondary liability against the officer. Hence he claims that when the primary claim against the corporation is barred, the secondary claim against the officer is also barred. Appellant does not claim that the assessments made against the corporation and the assessment made against him were not made within the time specified by Section 3312(a) supra. Appellant's only assertion is that this suit was not brought within the six-year period specified in Section 3312(d) supra after the date of the assessments against the corporation. As the assessment

[4]Sec. 7851 of the 1954 Code provides that the 1939 Code limitations shall govern action for taxes imposed thereunder.

against appellant was made November 23, 1949 and suit was filed on November 18, 1955, appellant must and does concede that the suit was filed within six years after the assessment against him.

Section 1622 of the Internal Revenue Code of 1939[5] provides for the collection of income taxes at source by requiring every employer to deduct and withhold a percentage of the wages paid to the employees. Section 1627 of the Internal Revenue Code of 1939[6] makes Section 2707(a) applicable to the collection of this tax. Similarly, Section 1400 of the Internal Revenue Code of 1939[7] imposes a tax on wages of employees as a

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[5]Sec. 1622. Income Tax Collected at Source.
"(a) [as added by Section 2(a) of the Current Tax Payment Act of 1943, c. 120, 57 Stat. 126 and amended by Sec. 501, Revenue Act of 1948, c. 168, 62 Stat. 110] *Requirement of Withholding.*— Every employer making payment of wages shall deduct and withhold upon such wages a tax equal to 15 per centum of the amount by which the wages exceed the number of withholding exemptions claimed multiplied by the amount of one such exemption as shown in subsection (b) (1), except that in the case of wages paid on or after November 1, 1951, and before January 1, 1954, the tax shall be equal to 20 per centum of such excess in lieu of 18 per centum."

[6]Sec. 1627. [as added by Section 2(a) of the Current Tax Payment Act of 1943, supra]
Other Laws Applicable.
"All provisions of law, including penalties, applicable with respect to the tax imposed by section 1400 shall, insofar as applicable and not inconsistent with the provisions of this subchapter, be applicable with respect to the tax under this subchapter.

[7]Sec. 1400. [as amended by Sec. 1 of Social Security Act Amendments of 1947, C. 510, 61 Stat. 793]
Rate of Tax.
"In addition to other taxes, there shall be levied, collected, and paid upon the income of every individual a tax equal to the following percentages of the wages (as defined in section 1426(a)) received by him after December 31, 1936, with respect to employment (as defined in section 1426(b)) after such date:
(1) With respect to wages received during the calendar years 1939 to 1949, both inclusive, the rate shall be 1 per centum."

contribution to their insurance under the social security, old age and survivors program. Section 1401 of the Revenue Code of 1939[8] imposes the duty to collect this tax upon the employer by deducting the amount of the taxes from the wages as and when paid. Section 1430 of the Internal Revenue Code of 1939[9] makes Section 2707(a) applicable to the collection of this tax. Where the employer has collected the tax but failed to pay it over to the United States, the employee is credited with payment, since the amount was deducted from his wages by the employer. *United States Fidelity & Guaranty Co. v. United States,* 201 F. 2d 118 (10th Cir., 1952). In our view, Section 2707(a) imposes a separate and distinct liability upon the officer of the corporation who has the duty or is responsible for the collection and payment of the tax and who willfully fails either to collect the tax or to pay it over. While this liability is denominated "penalty" it is "to be assessed and collected in the same manner as taxes are assessed and collected." While it might be said that the assessment made on appellant is derivative of the assessments made on the corporation, in that they both relate to taxes collected

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[8]Sec. 1401. Deduction of Tax From Wages.
"(a) Requirement.—The tax imposed by section 1400 shall be collected by the employer of the taxpayer, by deducting the amount of the tax from the wages as and when paid."

[9]Sec. 1430. [as amended by Sec. 903, Social Security Act Amendments of 1939, c. 666, 53 Stat. 1360]
Other Laws Applicable.
"All provisions of law, including penalties, applicable with respect to any tax imposed by section 2700 or section 1800, and the provisions of section 3661, shall, insofar as applicable and not inconsistent with the provisions of this subchapter, be applicable, with respect to the taxes imposed by this subchapter."

or withheld by the corporation, the liability imposed upon appellant by Section 2707(a) is statutory and in such cases the statutory limitations are controlling.

In urging that suit must be filed within six years after the date of assessment against the corporation, the appellant relies heavily upon *United States v. Updike,* 281 U.S. 489 (1930). This case is readily distinguishable from the instant case. The distinction was pointed out in *Signal Oil & Gas Co. v. United States,* 125 F. 2d 476, 482 (9th Cir. 1942), where this Court stated:

> "The Updike case, so cited and approved by the Supreme Court, was a suit against a transferee after assessment of the taxpayer, but without an assessment of the transferee. The applicable statute was held to be section 278(d) providing the six-year limitation after the assessment of the taxpayer and the suit against the unassessed transferee was held brought too late because commenced over seven years after the taxpayer's assessment."

The present action is not one against a transferee of property of an original taxpayer, nor is it one solely of derivative character. Rather, it is one of distinct and separate statutory liability. The fact that the suit was brought more than six years after the assessments against the corporation is immaterial. We hold that since the suit was filed within six years after the assessment against the appellant that it was timely instituted.

Appellant's second contention is predicated entirely on the assumption that he has been held liable for

the assessed taxes solely on the basis of the Commissioner's ex parte assessment. His argument in this respect reads as follows:

> "If the assessment is deemed to be duly made and to establish a prima facie case against the defendants, obviously it is an arbitrary and capricious exercise of the taxing power, and as such constitutes a violation of Amendment V of the Constitution of the United States, which provides that no person shall be deprived of property without due process of law. Likewise, such a summary determination appears to deprive defendants of a jury trial, to which they are entitled by Amendment VII of the Constitution. And, furthermore, such an assessment appears to violate the provisions of Amendment VIII of the Constitution, which provides that excessive fines shall not be imposed, nor shall cruel and unusual punishments be inflicted."

Appellant's argument is without merit since it completely overlooks the fact that he has been held liable not on the basis of an ex parte assessment but on the basis of a court judgment. That judgment applied Section 2707(a) and (d) to him on all of the facts of the case, at the close of all of the evidence, including the assessment as one factor. Appellant has raised no constitutional objection to the judicial proceedings which resulted in the judgment imposing liability upon him.

Under appellant's third contention that the trial court erred in finding that he was the responsible officer of the corporation, appellant urges: (a) that he was traveling most of the time and away from

the corporation's principal office; that he was not in charge of the administrative affairs of the corporation; that subordinates were in charge of the principal office and exercised the functions of general manager, and were also authorized to sign checks of the corporation; and that the corporation employed a bookkeeper and accountants, and appellant relied upon them insofar as the financial records and tax returns of the corporation were concerned; and (b) that the bank financing the corporation was in control of the corporation's finances from its inception, and dictated what disbursements should be made, and that it was the decision of the bank and not appellant in 1948 not to pay the withheld taxes.

Appellant was the founder of the corporation, was virtually its sole stockholder, and was its president and chief executive officer. There was testimony from the vice-president of the corporation that appellant was in charge of the entire operation, that he made the final decisions, and that he decided what creditors were to be or were not to be paid.

Bank officers testified that the bank never declined to authorize the issuance of checks to pay taxes; that the relation between the bank and the corporation was a normal one; that the bank did not interfere with the management of the corporation; and that the corporation was free to draw on its account to the extent that it had funds in the bank. Appellant's own testimony indicates that the corporation had funds in the bank in amounts in excess of the taxes due, but they were admittedly used to pay other bills. The record discloses that the appellant knew in January of 1948

that the taxes for the fourth quarter of 1947 were due; that they were not paid; that throughout 1948 the corporation continued to operate; that he decided to file returns without making payment of the taxes due because his attorney advised him that the returns must be filed even if the taxes due were not paid; that appellant continued to put money into the business; that he persuaded other creditors to accept debentures subordinate to taxes, expecting the business to pull out of its distress; that subsequent to the termination of the relationship with the allegedly interfering bank some corporate money was used to pay interest on the debenture bonds and to reduce the mortgage on the corporation's real property. While much of this money may have come from appellant's own funds, he conceded that some came from corporate funds.

Appellant's argument that subordinate officers in the corporation were in charge of the administrative and managerial activities of the corporation, and that, therefore, the trial court erred in finding that he was the responsible officer, is disposed of by this Court's recent decision in *Wilson v. United States*, 250 F. 2d 312 (9th Cir. 1958). While that case involved a criminal prosecution under Section 2707(c) of the Internal Revenue Code of 1939,[10] it is relevant with respect to

[10]Section 2707(c) reads as follows:
"Any person required under this subchapter to collect, account for and pay over any tax imposed by this subchapter, who willfully fails to collect or truthfully account for and pay over such tax, and any person who willfully attempts in any manner to evade or defeat any tax imposed by this subchapter or the payment thereof, shall, in addition to other penalties provided by law, be guilty of a felony and, upon conviction thereof, be fined not more than $10,000, or imprisoned for not more than five years, or both, together with the costs of prosecution."

the issue of who is a "person" responsible, since the definition of such a person in Section 2707(d) applies to both civil and criminal liability. In *Wilson,* we said, at 316:

> Appellant was chief executive officer of the corporation. It was his responsibility to determine how corporate funds should be expended. He was not himself the 'disbursing officer' for the corporation, but he had the final word as to what bills should or should not be paid and when. Possessed of such authority and power, he came within the purview of Section 2707(d) of the I.R.C. of 1939, which defines a 'person' subject to the preceding subsections of § 2707. . . ."

Appellant's reliance on *Cushman v. Wood,* 149 F. Supp. 644 (D. Ariz., 1956) on this phase of the case is misplaced. In that case the evidence established that the stockholders and directors sought to be charged had wholly delegated such authority to an office manager and did not participate in any way in the non-payment action.

Appellant's argument that the financing bank and not he was in control of the corporation's finances rests largely on appellant's own testimony. Some of such testimony is not corroborated by the documentary evidence, and some of the testimony is contradicted by the corporation's officer and the officers of the financing bank.

We have carefully examined the record in this case and are satisfied that the action of the trial court in finding appellant to be the responsible person is supported by substantial evidence. On appeal such find-

ing of the trial court cannot be set aside unless it is "clearly erroneous" under the doctrine of *United States v. United States Gypsum Co.*, 333 U.S. 364 (1948). As this Court said in *Overman v. Loesser*, 205 F. 2d 521, 524 (9th Cir., 1953), c.d. 346 U.S. 910 (1953), "Since the finding involved the credibility of witnesses, and since it is supported by substantial evidence, it is conclusive on appeal." We do not sit to second guess the trial court, nor have we the power to do so under Rule 52(a) of the Federal Rules of Civil Procedure, unless the findings are "clearly erroneous".

Appellant's final and fourth assertion of error is that the trial court applied an improper definition of "willfully" in concluding that appellant willfully failed to pay over the amount of taxes withheld or deducted from the wages of employees of the corporation, under the terms of Section 2707(a). This contention is based on the claim that he was prevented from paying the taxes by the financing bank, and that proof of a criminal intent or motive or purpose to violate the law was necessary to establish civil liability in this case. We have already disposed of appellant's contention that the withheld taxes were not paid over because of the financing bank's purported interference into the internal affairs of the corporation.

It must be borne in mind that the action instituted against appellant was not designed to impose criminal sanctions, but is a civil action to insure payment to the United States of a tax already collected or deducted by an employer, whose employees have already

received credit for the withheld taxes in their individual returns. Section 2707(a) does not provide for a "double" penalty. In our view there need not be present an intent to defraud or deprive the United States of the taxes collected or withheld for its account, nor need bad motives be present in order to invoke the sanctions of Section 2707(a). The decision of appellant as the responsible officer of the corporation not to have the corporation pay over to the government the withheld taxes was a voluntary, conscious, and intentional act to prefer other creditors of the corporation over the United States. In our view such conduct was willful within the meaning of Section 2707(a). See *Paddock v. Siemoneit*, 147 Tex. 571, 218 S.W. 2d 428; *In re Haynes*, 88 F. Supp. 379 (D. Kansas, 1948); *Kellems v. United States*, 97 F. Supp. 681 (D. Conn., 1951); *Nugent v. United States*, 136 F. Supp. 875 (N.D.Ill., 1955); *Levy v. United States*, 140 F. Supp. 834 (W.D. La., 1956).

Appellant relies on *Cushman v. Wood*, supra, as standing for the proposition that "willfully" in Section 2707(a) requires criminal conduct and means "without reasonable cause." The court there held, at page 646, "Thus, the basic elements of willfulness are evil motive, lack of justification, bad purpose, or something done or not done without justifiable excuse." We are unable to agree with the views thus expressed.

The judgment of the district court is affirmed.

(Endorsed:) Opinion. Filed Nov. 2, 1959.

Paul P. O'Brien, Clerk.

United States Court of Appeals
for the Ninth Circuit

Edward J. Bloom, Appellant, vs. United States of America, Appellee.	No. 16,127

JUDGMENT

Appeal from the United States District Court for the Northern District of California, Southern Division.

This cause came on to be heard on the transcript of the record from the United States District Court for the Northern District of California, Southern Division, and was duly submitted.

On consideration whereof, it is now here ordered and adjudged by this Court, that the Judgment of the said District Court in this cause be, and hereby is affirmed.

(Endorsed) Judgment

Filed and entered: November 2, 1959

Paul P. O'Brien, Clerk

In the United States District Court for the Northern District of California, Southern Division

United States of America, Plaintiff, vs. Edward J. Bloom and Helen Bloom, Defendants.	Civil No. 35,070

JUDGMENT

This cause came on to be heard on April 14, 15 and 16, 1958 and duly submitted on April 23, 1958, it was argued by counsel and thereupon, upon consideration thereof, it is Ordered, Adjudged and Decreed as Follows, viz:

1. That the United States shall have judgment against Edward J. Bloom in the amount of $19,292.79.

2. That the United States shall have its costs.

Dated, April 23, 1958.

Michael J. Roche,
United States District Judge.

(Endorsed) Filed Apr. 23, 1958

In the United States District Court for the Northern District of California, Southern Division

United States of America, Plaintiff, vs. Edward J. Bloom and Helen Bloom, Defendants.	Civil No. 35,070

JUDGMENT FOR DEFENDANT HELEN BLOOM

After trial without a jury, the Court finds that the defendant Helen Bloom, wife of defendant Edward J. Bloom, is not indebted to the plaintiff and the relief sought by plaintiff against defendant Helen Bloom is denied, and the plaintiff is directed to vacate the tax liens herein sued upon wherever recorded against the defendant Helen Bloom, also known as Helen M. Bloom, and clear County Recorders' records of such liens in Washington, Idaho and California and wherever else the same may be filed.

Entered this 23rd day of April, 1958.

Michael J. Roche,
Judge of the District Court.

(Endorsed) Filed Apr. 23, 1958

FILE COPY

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JAMES R. BROWNING, Clerk

No. 791

In the Supreme Court of the United States

OCTOBER TERM, 1959

EDWARD J. BLOOM, PETITIONER

v.

UNITED STATES OF AMERICA

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

BRIEF FOR THE UNITED STATES IN OPPOSITION

J. LEE RANKIN,
Solicitor General,
CHARLES K. RICE,
Assistant Attorney General,
A. F. PRESCOTT,
JOSEPH KOVNER,
Attorneys,
Department of Justice, Washington 25, D.C.

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In the Supreme Court of the United States

OCTOBER TERM, 1959

No. 791

EDWARD J. BLOOM, PETITIONER

v.

UNITED STATES OF AMERICA

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

BRIEF FOR THE UNITED STATES IN OPPOSITION

OPINIONS BELOW

The District Court wrote no opinion. The opinion of the Court of Appeals (Pet. i–xvi) is reported at 272 F. 2d 215.

JURISDICTION

The judgment of the Court of Appeals was entered on November 2, 1959 (Pet. xvii). A timely petition for rehearing was denied on January 20, 1960. The petition for a writ of certiorari was filed March 15, 1960. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

QUESTIONS PRESENTED

This action was instituted by the United States against petitioner, an officer of a corporation, to re-

cover the amount of income and social security taxes withheld from wages of employees of the corporation but not paid over to the United States. The questions are:

1. Whether such an action is timely if brought within six years after the date of the assessment against the officer, although more than six years after the assessment against the corporation.

2. Whether, in the proceedings resulting in the judgment below, petitioner was denied due process of law.

3. Whether the evidence supports the finding that petitioner was responsible for collecting and paying over the withheld taxes, and that he willfully failed to do so.

STATUTES INVOLVED

The relevant provisions of the Internal Revenue Code of 1939, Sections 1400, 1401, 1430, 1622, 1627, 2707, 3312, and 3661, are printed in the Appendix, *infra*, pp. 9–12.

STATEMENT

Petitioner was president, chief executive officer and majority stockholder of Idaho Smelting, Inc. ("Idaho"), a company engaged in the scrap aluminum business (Pet. ii-iii). Idaho had a line of credit with a bank under which credit was extended under an overdraft system of banking, and Idaho was required to buy and sell aluminum on a trust receipts basis (Pet. iii). In September 1947, when Idaho was substantially indebted to the bank, the metal market dropped drastically (*ibid.*). Thereafter, the bank "gradually exerted pressure on [Idaho] to

liquidate its inventory so as to insure that the bank will not suffer a loss on its loans" (Pet. iv). Idaho was liquidated during 1948 and by the end of the year, when its indebtedness to the bank had been paid, the company was practically without funds (*ibid.*).

On January 31, 1948, when the corporation filed a tax return for the last quarter of 1947, for the first time it failed to include payment for the income and social security taxes that it had withheld from its employees (Pet. iv). Throughout the remaining months of 1948, as the corporation continued to liquidate its inventory to satisfy the bank's demands, it filed returns showing the amount of income and social security taxes that had been withheld, but the taxes (with the exception of two quarters' social security taxes) were not paid (*ibid.*). The Government assessed the delinquent taxes against the corporation for each quarter, the last assessment having been made on May 17, 1949 (*ibid.*). In July, 1948, the Government filed tax liens against the corporation (*ibid.*).

On November 23, 1949, the Commissioner of Internal Revenue, acting under Section 2707(a) of the Internal Revenue Code of 1939 (*infra*, pp. 10–11), assessed against petitioner and his wife a liability for $13,448.45, which represented the amount of delinquent withheld taxes originally assessed against the corporation. The assessment was made on the ground that they were "persons who had willfully failed to pay, collect, or truthfully account for and pay over" the withheld taxes. When petitioner and his wife refused to pay the assessment, the instant suit was filed on No-

vember 18, 1955, to reduce the unpaid assessment to judgment (Pet. v).

After trial without a jury, the district court held that petitioner "was the responsible officer" of Idaho "whose duty it was to collect, account for and pay over" the withheld income and social security taxes, and that he had "willfully failed" to do so (Pet. v-vi), and entered judgment against him for $19,292.79 (Pet. xviii). The court held, however, that petitioner's wife was not liable for the assessment, and entered judgment in her favor (Pet. xix).

The court of appeals unanimously affirmed. In a comprehensive opinion (Pet. i-xvi), the court held that the suit was timely filed, since under the applicable statute of limitations the six-year period ran from the date the assessment was made against petitioner and not from the date the tax was assessed against the corporation (Pet. vi-x); that petitioner's contention that he had been denied due process of law because the Commissioner's assessment of his liability was made *ex parte* "is without merit since it completely overlooks the fact that he has been held liable not on the basis of an ex parte assessment but on the basis of a court judgment" (Pet. xi); that the trial court's finding that petitioner "was the responsible [corporate] officer whose duty it was to collect, account for, and pay over the withheld taxes" (Pet. vii) "is supported by substantial evidence" (Pet. xiv); and that petitioner's failure to pay over the withheld taxes was "willful within the meaning of Section 2707(a)" (Pet. xvi).

ARGUMENT

Section 2707 (a) and (d) of the 1939 Internal Revenue Code (*infra*, pp. 10–11) provide that a corporate officer who willfully fails to perform his duty to pay over to the Government income and social security taxes that the corporation has withheld from its employees shall be "liable to a penalty of the amount of the tax * * * not * * * paid over, to be assessed and collected in the same manner as taxes are assessed and collected." In the instant case, both courts below held that petitioner was the corporate officer who was responsible for paying over the withheld taxes, and that his failure to do so was willful. We submit that in affirming the judgment against petitioner in the amount of the taxes that he thus failed to pay over, the court of appeals correctly applied settled legal principles to the facts of this case, and that no issue is presented which warrants further review.

1. Section 3312(a) of the 1939 Code provides that all Internal Revenue taxes (with certain exceptions not here pertinent) shall be assessed within four years after they become due. Section 3312(d) provides that where a tax has been assessed within the applicable statutory period of limitations, a suit for its collection must be begun within six years after the assessment of the tax. The assessment of petitioner's liability under Section 2707 was made on November 23, 1949, which was less than 4 years after the corporation's initial failure on January 31, 1948, to pay the withheld taxes. The instant suit was instituted on November 18, 1955, which was less than 6 years after the assessment of the liability on November 23, 1949.

Thus, both the assessment of the liability and the instant suit for its collection were timely filed.

Petitioner contends (Pet. 25–27) that the statutory period begins to run from the date of the assessment of the tax against the corporation rather than its assessment against him. As the court of appeals pointed out (Pet. x), however, petitioner's liability is not that of the corporation, but a "distinct and separate statutory liability" for which a separate assessment is made. The limitations period runs from the date of the latter. *United States* v. *Updike,* 281 U.S. 489; *Signal Oil & Gas Co.* v. *United States,* 125 F. 2d 476, 482 (C.A. 9).

2. Petitioner's contention that he was not the officer of his corporation responsible for the payment to the government of the taxes withheld from its employees presents only a factual question that both courts resolved against petitioner. In its review of the evidence on this point, the court of appeals pointed out (Pet. xii) that there was testimony by the vice president "that appellant was in charge of the entire operation, that he made the final decisions, and that he decided what creditors were to be or were not to be paid." Petitioner's lengthy argument (Pet. 29–40) that he could not control the disbursement of corporate funds in its bank account because they were trust funds for the benefit of the bank confuses the security for the loan and the loan itself. The bank's loans to the corporation were made upon the security of trust receipts, and those receipts and the property that they represented were not subject to petitioner's control. But the proceeds of the loan were on deposit in the

corporation's regular checking account and these were regular funds of the corporation over which petitioner, as the chief executive, had full control. As the court below noted (Pet. xii), bank officers testified "that the corporation was free to draw on its account to the extent that it had funds in the bank."

3. Petitioner contends (Pet. 56–60) that a willful failure to pay over withheld taxes within the meaning of Section 2707 is not established unless it be shown that he had an evil motive or bad purpose. The contention is fully answered by the court below (Pet. xv-xvi), which applied the settled rule that a voluntary, conscious and intentional decision of a corporate officer to pay creditors with funds representing withheld taxes belonging to the United States is sufficient to impose civil liability therefor upon the officer. See *Paddock* v. *Siemoneit*, 147 Tex. 571, 218 S.W. 2d 428; *In re Haynes*, 88 F. Supp. 379 (D. Kan.); *Kellems* v. *United States*, 97 F. Supp. 681 (D. Conn.); *Nugent* v. *United States*, 136 F. Supp. 875 (N.D. Ill.); *Levy* v. *United States*, 140 F. Supp. 834 (W.D. La.).[1] Here the record shows (Pet. xii-xiii) that petitioner himself filed the quarterly corporate tax returns without paying the withheld taxes, although the corporation then had funds in its account

[1] Petitioner's contention (Pet. 28–29, 45–48) that he was denied due process of law because the liability was assessed against him *ex parte* has no substance. As the court of appeals pointed out (Pet. xi), petitioner was held liable for the withheld taxes "not on the basis of an ex parte assessment but on the basis of a court judgment." The judgment was not, as petitioner suggests (Pet. 28–29), based on the Government's prima facie opening evidence, but upon the entire record, in-

in excess of the taxes due, which were used to pay other bills.

CONCLUSION

For the foregoing reasons, it is respectfully submitted that the petition for a writ of certiorari should be denied.

J. LEE RANKIN,
Solicitor General.
CHARLES K. RICE,
Assistant Attorney General.
A. F. PRESCOTT,
JOSEPH KOVNER,
Attorneys.

MAY 1960.

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cluding petitioner's testimonial and documentary evidence, and the Government's rebuttal evidence. The validity of the levies that were made against petitioner based on the assessment is not involved in this suit. Cf. *Phillips* v. *Commissioner*, 283 U.S. 589. The fact that the suit was dismissed against petitioner's wife indicates nothing as to the sufficiency of the evidence against petitioner.

APPENDIX

STATUTES INVOLVED

Internal Revenue Code of 1939:

SEC. 1400 [as amended by Sec. 1 of Social Security Act Amendments of 1947, c. 510, 61 Stat. 793]. RATE OF TAX. TAX.

In addition to other taxes, there shall be levied, collected, and paid upon the income of every individual a tax equal to the following percentages of the wages (as defined in section 1426(a)) received by him after December 31, 1936, with respect to employment (as defined in section 1426(b)) after such date:

(1) With respect to wages received during the calendar years 1939 to 1949, both inclusive, the rate shall be 1 per centum.

* * * * *

(26 U.S.C. 1952 ed., Sec. 1400.)

SEC. 1401. DEDUCTION OF TAX FROM WAGES.

(a) Requirement.—The tax imposed by section 1400 shall be collected by the employer of the taxpayer, by deducting the amount of the tax from the wages as and when paid.

* * * * *

(26 U.S.C. 1952 ed., Sec. 1401.)

SEC. 1430 [as amended by Sec. 903, Social Security Act Amendments of 1939, c. 666, 53 Stat. 1360]. OTHER LAWS APPLICABLE.

All provisions of law, including penalties, applicable with respect to any tax imposed by section 2700 or section 1800, and the provisions of

section 3661, shall, insofar as applicable and not inconsistent with the provisions of this subchapter, be applicable with respect to the taxes imposed by this subchapter.

(26 U.S.C. 1952 ed., Sec. 1430.)

SEC. 1622. INCOME TAX COLLECTED AT SOURCE.

(a) [as added by section 2(a) of the Current Tax Payment Act of 1943, c. 120, 57 Stat. 126 and amended by Sec. 501, Revenue Act of 1948, c. 168, 62 Stat. 110] *Requirement of Withholding.*—Every employer making payment of wages shall deduct and withhold upon such wages a tax equal to 15 per centum of the amount by which the wages exceed the number of withholding exemptions claimed multiplied by the amount of one such exemption as shown in subsection (b) (1).

* * * * *

(26 U.S.C. 1946 ed., Supp. II, Sec. 1622.)

SEC. 1627 [as added by Section 2(a) of the Current Tax Payment Act of 1943, *supra*]. OTHER LAWS APPLICABLE.

All provisions of law, including penalties, applicable with respect to the tax imposed by section 1400 shall, insofar as applicable and not inconsistent with the provisions of this subchapter, be applicable with respect to the tax under this subchapter.

(26 U.S.C. 1952 ed., Sec. 1627.)

SEC. 2707. PENALTIES.—

(a) Any person who willfully fails to pay, collect, or truthfully account for and pay over the tax imposed by section 2700(a), or willfully attempts in any manner to evade or defeat any such tax or the payment thereof, shall, in addition to other penalties provided by law, be liable to a penalty of the amount of the tax evaded, or not paid, collected, or accounted for and paid over, to be assessed and collected in the same manner as taxes are assessed and collected. No

penalty shall be assessed under this subsection for any offense for which a penalty may be assessed under authority of section 3612.

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(d) The term "person" as used in this section includes an officer or employee of a corporation, or a member or employee of a partnership, who as such officer, employee, or member is under a duty to perform the act in respect of which the violation occurs.

(26 U.S.C. 1952 ed., Sec. 2707.)

SEC. 3312. PERIOD OF LIMITATION UPON ASSESSMENT AND COLLECTION.

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(a) *General Rule.*—All internal revenue taxes shall (except as provided in subsections (b), (c), and (d)) be assessed within four years after such taxes became due, and no proceeding in court without assessment for the collection of such taxes shall be begun after the expiration of five years after such taxes became due.

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(d) *Collection after Assessment.*—Where the assessment of any tax imposed by this title has been made within the statutory period of limitation properly applicable thereto, such tax may be collected by distraint or by a proceeding in court, but only if begun—

(1) Within six years after the assessment of the tax, or

(2) Prior to the expiration of any period for collection agreed upon in writing by the Commissioner and the taxpayer.

(26 U.S.C. 1952 ed., Sec. 3312.)

SEC. 3661. ENFORCEMENT OF LIABILITY FOR TAXES COLLECTED.

Whenever any person is required to collect or withhold any internal-revenue tax from any other person and to pay such tax over to the United States, the amount of tax so collected or withheld shall be held to be a special fund in trust for the United States. The amount of such fund shall be assessed, collected, and paid in the same manner and subject to the same provisions and limitations (including penalties) as are applicable with respect to the taxes from which such fund arose.

(26 U.S.C. 1952 ed., Sec. 3661.)

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